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COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

REPORT AND RECOMMENDATIONS CONCERNING FEDERAL TAX RULES GOVERNING PRIVATE FOUNDATIONS

SEPTEMBER 28, 1983

Prepared for use by the Committee on Ways and Means by its staff

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LETTER OF TRANSMITTAL

COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, D.C., September 28, 1983.

Hon. DAN ROSTENKOWSKI,
Chairman, Commiitee on Ways and Means,
Longworth House Office Building,
Washington, D.C.

DEAR MR. CHAIRMAN: This letter transmits the report and recommendations of the Subcommittee on Oversight concerning Federal tax rules which govern private foundations. For purpose of examining these rules, the Subcommittee held 3 days of public hearings on June 27, 28, and 30, 1983.

The report includes a legislative history of the private foundation provisions of the Internal Revenue Code, a summary of present law foundation and charitable deduction rules, general findings, and a series of Subcommittee recommendations.

Mr. Chairman, the Subcommittee respectfully submits its review of these issues for your consideration.

Sincerely yours,

CHARLES B. RANGEL,
Chairman.

Enclosures.

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ACKNOWLEDGMENT

The Subcommittee wishes to express its appreciation to the U.S. General Accounting Office, the staff of the Joint Committee on Taxation, and the Congressional Research Service of the Library of Congress for their assistance in the preparation of this report.

I. INTRODUCTION

Overview

The private foundation provisions of present law (i.e., the basic rules enacted in the Tax Reform Act of 1969) were enacted in light of findings that neither the general requirements for tax-exempt status, nor the specific rules under prior law governing foundation transactions and expenditures, had proved effective to ensure that Federal income tax incentives would be available only where a foundation's assets and income are devoted to charitable, and not private, purposes. Accordingly, since the rationale underlying the deductibility of contributions and tax-exempt status is the encouragement of private giving to carry out charitable programs and activities, current law provides rules and excise tax sanctions designed to ensure that the expenditures, investments, and transactions of private foundations will be consistent with this underlying rationale for favorable tax treatment.

Outline of Present Law

Under present law, generally private foundations are defined as all charitable, educational, or religious organizations (including trusts with charitable, etc. beneficiaries) *other than—*

(1) Several categories of organizations which, under prior law, had been eligible for favorable charitable deduction rules. These public charities include certain organizations defined by reference to their nature (such as churches, schools, and hospitals) and others defined by reference to their broad public support or governmental funding (such as the United Givers Fund or publicly supported community centers, museums, libraries, etc.).

(2) An additional category of organizations which receive broad public support in the form of contributions, membership fees, or receipts from admissions, etc. (including publicly supported membership organizations such as parent-teacher associations (PTA's), scouting groups, etc.).

(3) Organizations formed exclusively to benefit, and which are controlled by or operate in connection with, public charities (such as scholarship trusts operated in connection with a college).

Organizations which fail to qualify under any of these three categories of public charities are classified for tax purposes as either private nonoperating foundations—basically, grantmaking foundations—or as private operating foundations—basically, foundations which themselves directly engage in charitable, etc. functions.

Private foundations are governed by a series of rules, enacted in the Tax Reform Act of 1969 (violations of which trigger excise taxes), that require private foundations to maintain a specified minimum level of charitable expenditures or grants, that limit the extent to which foundations may control business enterprises, and that prohibit foundations from making speculative investments, from making grants to organizations other than public charities without exercising expenditure responsibility, and from engaging in "self-dealing" transactions with related persons. In addition, an excise tax of 2 percent is imposed on the net investment income of private foundations. Foundations must also file information returns with the Internal Revenue Service (IRS) and disclose certain information to the public.

Outline of Charitable Contribution Rules

Since the 1954 Internal Revenue Code, the income tax treatment of contributions to private foundations generally has been less favorable than the treatment of contributions to public charities. Present law generally retains preferential tax treatment for contributions to public charities as opposed to contributions to private foundations (except for private operating foundations).

Deductions for gifts by individuals to private nonoperating (grantmaking) foundations are limited to 20 percent of the donor's adjusted gross income. Gifts to most other charitable entities are subject to 30 and 50 percent limitations.

A five-year carryover of excess contributions by individuals is generally permitted unless the contributions have been made to a private nonoperating foundation.

Contributions of appreciated property are generally deductible at fair market value, but the deduction for gifts of appreciated property and tangible personal property to private nonoperating foundations is reduced by 40 percent of the difference between fair market value and the donor's basis (i.e., by 40 percent of the unrealized appreciation).

Profile of Foundations

Operated with limited public support or involvement and managed by its own trustees or directors, private foundations aid a variety of social, educational and charitable activities serving the public welfare.

The Internal Revenue Service estimates that at the end of calendar year 1982 there were 33,308 organizations classified as private foundations. For return year 1981, IRS data shows that 31,866 private foundations held assets valued at $50.9 billion. The Foundation Center[1] estimates that there are currently 22,535 active grantmaking foundations with combined assets of $41.6 billion, and that in fiscal year 1980 nearly $2.8 billion was paid out by foundations as contributions, gifts, and grants.

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[1] The Foundation Center is a nonprofit, fact-finding organization with the principal mission of gathering and disseminating information to the public on private foundations and the grants they give.

II. PURPOSE OF SUBCOMMITTEE HEARINGS

At the request of the Honorable Dan Rostenkowski, Chairman of the Committee on Ways and Means, the Subcommittee on Oversight held three days of public hearings on June 27, 28, and 30, 1983, on the Federal tax rules applicable to private foundations.[1]

In 1969, Congress enacted a comprehensive series of rules regulating private foundations. With limited exceptions, there has been no thorough review of these rules since the enactment of the Tax Reform Act of 1969 (P.L. 91-172). The hearings were held to develop information which would assist the Committee on Ways and Means in determining whether the foundation provisions enacted in the Tax Reform Act of 1969,[2] ensure that only those private foundations operating for the public benefit enjoy favorable tax treatment without imposing unnecessary or unduly burdensome restrictions.

In addition to seeking information on issues surrounding present law rules governing private foundations, the Subcommittee also sought information on the following general issues:

(1) The role private foundations play in private philanthropy;

(2) the types of philanthropic activities private foundations undertake and the beneficiaries of their charitable distributions;

(3) how private foundations have responded to reductions in Federal spending for various social programs; and

(4) the value of foundation assets, the types of assets they hold, and the level of foundation charitable distributions.

In the 98th Congress, a number of bills have been introduced to modify various private foundation rules or to provide exceptions to particular rules. While these bills were not specifically the focus of the Subcommittee hearings, as part of its review of the rules which govern private foundations, the Subcommittee examined proposed changes to those rules in the light of the policies which underlie present law.

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[1] The letter of request from Chairman Rostenkowski to the subcommittee is reproduced in the appendix. In addition, the press release announcing the Subcommittee on Oversight hearings is contained in the appendix.

[2] Although certain provisions of the rules enacted in 1969 have been modified subsequently, the basic structure of these rules remains unchanged.

III. LEGISLATIVE HISTORY OF THE PRIVATE FOUNDATION PROVISIONS IN THE INTERNAL REVENUE CODE[1]

A. Developments Before 1969

Origin of Exemption and Deduction

Prior to the Tax Reform Act of 1969, there was no statutory definition of "private foundation". Although Congress began to make distinctions among types of tax-exempt organizations prior to 1969, in the early years of the modern income tax all charitable organizations were treated alike.

When the modern corporate income tax was enacted in 1909, it contained an exemption for "any corporation or association organized and operated exclusively for religious, charitable, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual.[2]

With several additions and minor amendments that language has formed the backbone of the provisions exempting charitable organizations from income tax since 1909. The equivalent provision under curent law is found in IRC § 501(c)(3), to which both public charities and private foundations look for their exemption from income taxes today.

Another tax provision of overriding importance to both public charities and private foundations is the charitable contribution deduction, which generally allows donors to deduct from taxable income the value of money and property given to charitable organizations. The charitable contribution deduction from income tax became law in 1917.[3] The rules governing that deduction are currently in IRC § 170. The related charitable contribution deductions for estate and gift taxes were enacted in 1919 and 1924, respectively.[4] These provisions can now be found in IRC §§ 2055 and 2522.

Annual Report Requirement

Except for a provision of the Revenue Act of 1934 prohibiting charitable organizations from carrying on propaganda or lobbying,[5] Congress did not give serious legislative attention to charitable organizations until the Revenue Act of 1943. Until the adoption of that Act, exempt organizations were not required to file annual returns. The 1943 Act required certain exempt organizations to list their gross incomes, receipts, and disbursements in an effort to collect information on whether certain business activities ought to be taxed. However, religious organizations, schools, certain fraternal organizations, publicly supported charitable organizations, and certain Government corporations were exempted from this requirement.[6] The committee reports do not explain why the distinctions among types of exempt organizations were made.

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[1] This summary is excerpted from a legislative history prepared by the Congressional Research Service of the Library of Congress: "Development of the Law and Continuing Legal Issues in the Tax Treatment of Private Foundations," Committee on Ways and Means, WMCP: 98-9.

[2] Act of Aug. 5, 1909, ch. 6, § 38 [1st], 36 Stat. 11.

[3] Revenue Act of 1917, ch. 63, § 1201(2), 40 Stat. 300.

[4] Revenue Act of 1918, Act of Feb. 24, 1919, ch. 18, § 403(a)(3), 40 Stat. 1057 [the provision was retroactive for all of 1918]; Revenue Act of 1924, Act of June 2, 1924, ch. 234, § 321(a)(2), 43 Stat 253.

[5] Revenue Act of 1934, ch. 277, § 101(6), 23(o)(2), 48 Stat. 680, 690, 700.

Unrelated Business Activities

During the early years of the income tax there was uncertainty regarding the tax-exempt status of charitable organizations which carried on a commercial business, and whether such businesses were subject to income tax. In 1924, the Supreme Court's decision in *Trinidad* v. *Sagrada Orden,* 263 U.S. 578, seemed to indicate that a charitable organization could conduct a business which would be exempt from taxes as long as all the income from the business was devoted to charitable purposes.

This case gave birth to the so-called "destination of income" test. For some courts and some taxpayers, the destination of income test became a more important issue than the statutory language which required that the association or corporation be "organized and operated exclusively" for charitable purposes. In the next few decades, taxpayers and charitable organizations attempted to carry the destination of income test to its logical limits.

Revenue Act of 1950

In the Revenue Act of 1950, Congress expressed its concern that businesses which channeled their profits to exempt organizations were not carrying out any exempt purpose and that they were gaining an unfair competitive advantage over taxable businesses by enacting the "feeder organization" rules and a tax on the "unrelated business income" of exempt organizations.[7] The feeder organization rules overturned the "destination of income" test and denied tax-exemption to businesses which channeled their profits to exempt organizations. The unrelated business income tax imposed corporate income taxes on the unrelated business income of exempt organizations, in excess of $1,000 a year. (Churches were exempted from the tax.) Exempt organizations conducting a trade or business were to be taxed like regular corporations.[8]

As passed by the House, the Revenue Act of 1950 also prohibited any self-dealing transactions between certain exempt organizations and substantial contributors or their relatives. In addition, the House-passed bill contained a tax on accumulated investment income not paid out two-and-a-half months after the end of the tax year. The Senate bill modified the prohibited transactions rules to require arm's-length dealing, and substituted a requirement for reporting of accumulations in an exempt organization's annual report. The Conference Committee essentially adopted the Senate proposals, adding a denial of exemption for unreasonable accumulations.[9]

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[6] Revenue Act of 1943, Act of Feb. 25, 1944, ch. 63, § 117(a), 58 Stat. 36. (The provision was effective for tax years beginning in 1943.)

[7] In hearings held in 1950, the Committee on Ways and Means reviewed the Report of a Subcommittee of the Senate Committee on Interstate and Foreign Commerce, 81st Cong., 1st Sess., on the Investigation of Closing of Nashua, N.H., Mills and Operations of Textron Incorporated, which was reprinted in the 1950 hearings (pp. 510-530). This report detailed how Royal Little and his company, Textron, Inc., used charitable trusts as a means of providing risk capital to Textron. According to the report, Textron gained an unfair competitive advantage and only an "infinitesimal portion" of the many millions of dollars received by the trusts were paid to the beneficiaries of the trusts. Revenue Revision of 1950: Hearings before the Committee on Ways and Means, 81st Cong., 2d Sess.

[8] Revenue Act of 1950, ch. 994, §§ 301 (a) and (b), 64 Stat. 906, 948, 953, adding 1939 IRC §§ 54(f) and 421-423.

As finally enacted, certain organizations could lose their exemptions for engaging in specified self-dealing activities with substantial contributors or other related persons; for unreasonable accumulation of income; for using their income for non-exempt purposes; or for investing their income in a manner which would jeopardize the exempt purposes of the organization.[10]

Certain organizations (e.g., religious organizations, schools, publicly supported organizations, etc.) were excepted from the coverage of the prohibited transactions and unreasonable accumulation of income rules.

Internal Revenue Code of 1954

From the enactment in 1917 of a tax deduction for gifts to charitable organizations until 1952, the amount deductible was limited to 15 percent of the donor's adjusted gross income. In 1952 the deductible amount was raised to 20 percent of the donor's adjusted gross income.

In 1954, Congress enacted the Internal Revenue Code of 1954 which modified the charitable deduction rules of prior law. First, the limit on allowable charitable contribution deductions was raised from 20 to 30 percent of adjusted grosss income, providing that the extra 10 percent was made to one of three types of organizations: religious, educational or certain hospital organizations.[11] These roughly correspond to today's public charities. (Present law contains two additional categories of publicly supported organizations.) Second, the participation of tax-exempt organizations in political campaigns was restricted.

The rationale for the increase in the deductible amount for contributions to certain organizations was explained in the Report of the Committee on Ways and Means as being "designed to aid these institutions in obtaining the additional funds they need, in view of their rising costs and the relatively low rate of return they are receiving on their endowment funds."[12] No explanation was made as to why the other organizations were not experiencing the same difficulties.

Revenue Act of 1964

The Revenue Act of 1964 extended the 30 percent maximum charitable contribution deduction to most charitable organizations which were not private foundations. The report of the Committee on Ways and Means stated that the Committee recognized the many beneficial activities that were carried on by various philanthropic organizations which were not eligible for the 30-percent deduction. However, the Committee noted that private foundations frequently did not make contributions to operating philanthropic organizations for extended periods of time and in the meanwhile used the funds for investment. Therefore, the extra 10-percent deduction was intended to encourage immediately spendable receipts of contributions for charitable organizations.[13]

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[9] H. Rep't. No. 2319, 81st Cong., 2d sess. 40–42 (1950), S. Rep't. No. 2375, 81st Cong., 2d sess. 34–37 (1950).

[10] Revenue Act of 1950, ch. 994, § 331, 64 Stat. 906, 957, adding 1939 IRC § 3814.

[11] Ch. 736, 170(b)(1), 68A Stat. 58.

[12] H. Rep't. No. 1337, 83d Cong., 2d Sess. 25 (1954).

Congressional Investigations

In the years between 1950 and 1969, there were three major congressional investigations of private foundations. Interestingly, none of these were conducted by the tax-writing committees. The first two were born of the searches for Communist-influenced organizations in the early 1950s. The third was a 10-year investigation conducted by Representative Wright Patman and the Select Committee on Small Business, Subcommittee on Foundations.

Cox Committee

On April 4, 1952, the House created a Select Committee to Investigate Tax-Exempt Foundations and Comparable Organizations to determine which foundations were using their resources for nonexempt purposes, especially "un-American" or "subversive" activities.[14] The Select Committee, chaired by Representative E. E. Cox of Georgia and known as the "Cox Committee," held hearings in November and December [15] and made its report on January 1, 1953.[16] The Cox Committee endorsed the "great and significant services" of foundations, concluding that foundations seemed "to be a vital and essential factor in our progress." [17]

In reviewing the criticisms of foundations, the Cox Committee reported that there was little support for the allegation that foundation funds were being diverted from their intended use or infiltrated by subversives, but recommended public accounting to eliminate possible abuses.

The Committee recommended that the names of contributors and amounts of contributions over $200 ought to be disclosed to the Bureau of Internal Revenue and that the foundations ought to publicly disclose all grants.

Chairman Cox died before the Select Committee issued its report. Representive B. Carroll Reece of Tennessee appended a note to the report emphasizing the short deadline under which the committee had operated and suggesting that a more thorough study be undertaken by the following Congress.

Reece Committee

In 1953, the House authorized the creation of the Special Committee to Investigate Tax-Exempt Foundations and Comparable Organizations to determine if any foundations and organizations were using their resources for non-exempt purposes, subversive activities, political purposes, propaganda, or to influence legislation. This committee, chaired by Congressman Reece, conducted hearings in 1954 and presented its report on December 16, 1954.[18]

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[13] H. Rep't. No. 749, 88th Cong., 1st Sess. (1963); P.L. 88-272, § 209, 78 Stat. 43.

[14] H. Res. 561, 82d Cong., 2d Sess., 98 Cong. Rec. 3489 (1952).

[15] Tax-Exempt Foundations: Hearings before the House Select Committee to Investigate Tax-Exempt Foundations and Comparable Organizations, 82d Cong., 2d Sess. (1952).

[16] H. Rep't. No. 2514, 82d Cong., 2d Sess. (1953).

[17] Id. at 6-7.

The majority of the committee focused on criticisms of foundations,[19] and the tone of the majority report was quite antagonistic. The majority found that the number of foundations was increasing rapidly and the motivation for the increase was tax-planning rather than charity. The majority believed that the Internal Revenue Service was not staffed adequately to scrutinized the propriety and legality of the work of foundations. The majority emphasized that the public should be made aware of the impact of foundations on national affairs.

In spite of this apparent hostility to foundations, the committee report rejected the idea of abolishing foundations, the idea of eliminating Federal tax exemption for foundations, and the idea of national incorporation of foundations. The Reece Committee did recommend continuing the investigation of foundations using background research rather than taking witnesses' statements. It was thought that balance sheets and lists of assets and other types of documentary evidence needed to be analyzed by professionals.

Several of the Reece Committee's recommendations presaged provisions of current law. For example, the Reece Committee recommended that the Committee on Ways and Means define and distinguish private foundations from other tax-exempt charitable organizations; study the advisability of denying a tax exemption to foundations holding more than five or ten percent of their capital in securities of one enterprise; and consider giving foundations a limited period of two to five years to bring their holdings down to the prescribed level whenever they received a large holding. The Reece Committee also recommended that foundations be given a two or three year period to distribute each year's income, including capital gains. In addition, the Reece Committee report recommended that loss of a tax exemption should not be limited to the effective date of the revocation of the exemption. The thought was that a non-exempt organization should not be able to control a fund of assets which it had accumulated as an exempt organization. It was though that the threat of retroactive revocation of the exemption to the extent of the foundation's remaining assets would discourage subversive activities.

Patman Investigations

During May 1961, Representative Wright Patman placed four statements in the Congressional Record detailing the growth of foundations since 1939 in numbers, asset size, and influence; commenting on the lack of legal supervision of foundations; expressing his belief that because foundations were created with tax-deductible funds and operated under tax-exempt status, foundations and their money were public trusts; and describing the limitations under which the IRS operated and the need for clearer laws. Mr.

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[18] Tax Exempt Foundations: Hearings before the House Special Committee to Investigate Tax-Exempt Foundations and Comparable Organizations, 83d Cong., 2d Sess., on H. Res. 217 (1954); H. Rep't. No. 2681, 83d Cong., 2d Sess. (1953).

[19] H. Rep't. No. 2681, 83d Cong., 2d Sess. 3 (1954).

Patman reminded the Members of the earlier congressional investigations of foundations and of the Reece Committee's recommendations that a research-backed investigation be done. Each of these statements suggested that Congress ought to investigate these matters.[20]

In August 1961, Mr. Patman announced on the floor that he had begun a study of foundations and that he would report his findings to the House of Representatives from time to time.[21] In September Representative Thomas B. Curtis accused Mr. Patman of acting improperly in conducting his own investigation and suggested that such an investigation ought to be referred to a committee. Mr. Curtis suggested that the Committee on Ways and Means was probably the proper forum, although he could see reasons for the investigation being referred to the Joint Economic Committee or the Select Committee on Small Business. Mr. Patman resisted Mr. Curtis' suggestions, indicating that he was merely in an information collection stage and that at such time as he thought there ought to be an investigation he would refer it to a committee. He especially resisted the suggestion of referral to the Committee on Ways and Means, stating that this was a small business matter and involved the whole economy. He admitted that Ways and Means had jurisdiction but stated they had not touched the question at all for a number of years.[22]

To begin his investigation, Mr. Patman had sent inquiries to over 500 foundations asking for information on their activities. In January 1962, the Select Committee on Small Business, of which Mr. Patman was chairman, formed a new subcommittee on foundations and their impact on small business. Mr. Patman became chairman of the subcommittee, a position he retained even after he relinquished the chair of the full committee in order to become chairman of the Banking and Currency Committee. Over the next 10 years, Mr. Patman issued eight installments of his report on foundations. These reports emphasized the business involvement of tax exempt foundations.

The first report, issued in December 1962, began with a call for an immediate moratorium on foundation tax exemptions for the following reasons:

1. Laxness and irresponsibility on the part of the Internal Revenue Service.
2. Violations of law and Treasury regulations by far too many of the foundations encompassed in the study.
3. The withdrawal of almost $7 billion from the reach of tax collectors for taxable years 1951 through 1960.
4. The rapidly increasing concentration of economic power in foundations.
5. Foundation-controlled enterprises possess the money and competitive advantages to eliminate the small businessman.[23]

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[20] 107 Cong. Rec. 7016–17; 7250–51; 7433–34; 7566–7566 (1961).

[21] 107 Cong. Rec. 14789–797 (1961).

[22] 107 Cong. Rec. 18632–18642 (1961). Mr. Curtis was a member of the Committee on Ways and Means and the Joint Economic Committee. Mr. Patman was chairman of the Joint Economic Committee and the Select Committee on Small Business.

[23] Select Committee on Small Business (Chairman's Report), 87th Cong., 2d Sess., Tax-Exempt Foundations and Charitable Trusts: Their Impact on Our Economy 1 (Comm. Print 1962) [hereinafter Patman Report, 1st Installment].

Each of these allegations was expanded at length to justify future study of the problems in each area. The first installment concluded with 17 recommendations, including:

1. Limiting the life of foundations to 25 years;
2. Prohibiting foundations from engaging in business directly or indirectly;
3. Banning commercial money lending and borrowing;
4. Enforcing the arms's-length relationships rules;
5. Prohibiting foundations from soliciting or accepting contributions from suppliers;
6. Limiting foundations' ownership of stock to 3 percent of any corporation and prohibiting foundations from voting their stock;
7. Denying charitable contribution deductions to persons who control foundations until the money is actually used for charity;
8. Altering rules on the value of gifts given to foundations;
9. Treating contributions and capital gains as income not capital; and
10. Applying the corporate accumulated earnings tax to controlled foundations.[24]

The second installment of the Patman reports was issued in October 1963, and the third installment was published in March 1964.[25] These reports criticized the Treasury for "splendidly ineffective supervision" which allowed charitable foundations to be used for tax avoidance and control of business.[26] The reports studied four groups of foundations, detailing their activities and alleged abuses of tax-exempt status: the Baird Foundations; the Jessie Smith Noyes Foundation; the Lawrence A. Wien Foundations and the Harry B. Helmsley Foundation; and the Alfred I. du Pont Estate and the Nemours Foundation.

In 1966, the fourth installment of the Patman reports summarized the expenditures of 575 foundations. The report stated that less than half of their receipts (48 percent) were distributed; roughly 10 percent of receipts went to administrative expenses.[27] The fifth installment contained over 1000 pages of information concerning the James Irvine Foundation[28] and the continuing contest between the foundation managers and the heirs of James Irvine over control of the Irvine Co.

The sixth installment studied the foundations of America's wealthiest families, criticized their expenditures (not enough, too much overseas), criticized the use of foundations to escape estate taxes, to control businesses, to pay obligations to relatives, to pay annuities to themselves, and criticized the Treasury as a toothless watchdog.[29] The seventh installment was issued while the Congress was considering the Tax Reform Act of 1969. That installment consisted of Mr. Patman's testimony on the topic before the House Committee on Ways and Means.[30]

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[24] Patman Report, First Installment, at 133-134.

[25] Subcommittee Chairman's Report to Subcommittee No. 1, Select Committee on Small Business, 88th Cong., 1st Sess., Tax-Exempt Foundations and Charitable Trusts: Their Impact on Our Economy (Second Installment) (Comm. Print 1963) [subsequent Patman reports will be installment, congress, and date] Patman Report, Third Installment, 88th Cong., 2d Sess. (Comm. Print 1964).

[26] Patman Report, Second Installment, at ix.

[27] Patman Report, Fourth Installment, 89th Cong 2d Sess. 3 (1966).

[28] Patman Report, Fifth Installment, 90th Cong., 1 Sess. (1967).

[29] Patman Report, Sixth Installment, 90th Cong., 2d Sess. (1968).

The eighth installment was a study of the 1968 annual reports of 20,166 private foundations. The study was an attempt to develop comprehensive financial data for all private foundations in order to gain statistical insights into the economic impact of foundations. It was believed that the information would be especially useful for comparative purposes in determining the effectiveness of the Tax Reform Act of 1969.[31]

1965 Treasury Report on Private Foundations

In 1965, at the request of the House Committee on Ways and Means and the Senate Finance Committee, the Treasury Department issued a report on private foundations.[32] For the purposes of its report, Treasury defined a private foundation in a way which presaged the definition enacted in the 1969 Tax Reform Act. Private foundations were defined as all organizations granted tax exemption by IRC § 501(c)(3) with the exception of:

> (a) Organizations which normally receive a substantial part of their support from the general public or governmental bodies;
>
> (b) Churches or conventions or associations of churches;
>
> (c) Educational organizations with regular faculties, curriculums, and student bodies; and
>
> (d) Organizations whose purpose is testing for public safety; and nonexempt trusts empowered by their governing instruments to pay or permanently set aside amounts for certain charitable purposes.

The problems identified by Treasury included: [33]

1. *Delay in benefit to charity.* Treasury found the provision of then existing law which denied an organization tax exemption for unreasonable accumulations, or substantial noncharitable use of, income was difficult to apply and enforce because of its indefiniteness. Treasury recommended that private foundations be required to devote all of their net income to active charitable operations on a reasonably current basis. Treasury objected to retention of income to increase the capital of the foundation. Treasury tempered this distribution requirement by recommending a rule permitting accumulation for a specified reasonable period if the purpose was clearly identified in advance and accumulation would have been necessary. Treasury also suggested a five-year carryforward of excess contributions. For foundations with investments in low-yielding assets, Treasury recommended requiring a minimum

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[30] Patman Report, Seventh Installment, 91st Cong., 1st Sess. (1969).

[31] Staff Report for the Subcommittee on Domestic Finance, House Committee on Banking and Currency, 92d Cong., 2d Sess., Tax-Exempt Foundations and Charitable Trusts: Their Impact on Our Economy [Eighth Installment] (Comm. Print 1972). [The jurisdiction for the study was transferred from Subcommittee No. 1 of the House Select Small Business Committee to the Committee on Banking and Currency on April 27, 1971. Effective January 3, 1975 (H. Res. 988, 93d Cong.) jurisdiction over tax-exempt foundations and charitable trusts was transferred to the Committee on Ways and Means.]

[32] House Committee on Ways and Means, 89th Cong., 1st Sess. Treasury Department Report on Private Foundations iii, 1-2 (1965).

[33] Id. at 6-14.

distribution equal to the greater of the net income or a percentage of asset value.

2. *Foundation involvement in business.* The Treasury Report indicated that some foundations owned controlling interests in one or more businesses ranging from large metropolitan newspapers to radio broadcasting stations, lumber companies, clothing manufacturers, department stores to hotels. The Report discussed possible unfair competitive advantages of businesses owned or controlled by foundations (or vice-a-versa). For example, commercial business could capitalize a subsidiary only with after-tax dollars. However, if the company "donated" tax-deductible money to a foundation, the foundation could set up or buy the same subsidiary for about half the price after taxes to the controlling company. Foundations could lease business assets to taxable subsidiaries which would pay the foundation tax-deductible rent. The rental income received by the foundation would not be taxable. The foundation could accumulate this tax-free income and reinvest or loan the money in the business it controlled. Treasury found that neither the unrelated business income tax or the feeder organization rules would stem the disadvantages for regular businesses, opportunities for self-dealing, and diversion of foundation management to business rather than charitable concerns. Treasury recommended prohibiting foundations from owning 20 percent or more of a business unrelated to the charitable activities of the foundation.

3. *Family use of foundations to control corporate and other property.* The Treasury Report also voiced concern that foundations could be used as convenient vehicles for maintaining control of a family corporation while diminishing the burden of income, gift, and estate taxes for the family. A donor could give the foundation sufficient stock in a corporation to generate a generous charitable contribution deduction and at the same time reduce the value of the equity in the corporation which the donor controlled. This would reduce any estate or gift taxes at the time the donor passed control to the next generation. Family dominance of the private foundation would assure that the transfer of shares in the corporation to the foundation in the corporation would not result in outsiders running the family business.

Family control was found to aggravate the other problems of private foundations such as self-dealing, conflict of interest, and delay in or absence of benefit to the charity. Treasury recommmended disallowing charitable contribution deductions (either income or estate tax) for transfers of interest in family corporations until the foundation disposed of the contributed asset, the foundation devoted the asset to active charitable operations, or donor control over the business or asset terminated. Control would have been presumed to exist if the donor or related parties owned at least a 20-percent interest in the corporation.

4. *Financial transaction unrelated to charitable functions.* The Treasury recommended prohibiting all borrowing for investment purposes by private foundations; it recommended limiting foundation lending activities to necessary, safe and appropriate investments; and it proposed prohibiting foundations from trading and speculating in securities. Treasury was concerned that private par-

ties were able to shift the benefits of a foundation's tax exemption to themselves by using a foundation as an intermediary.

5. *Self-dealing.* The Treasury found that the "arm's-length" standards imposed by the Revenue Act of 1950 were so imprecise that the law was difficult and expensive to administer. Foundation donors could call upon their foundations to make loans to themselves and their businesses. Donor-trustees could keep foundation funds liquid if they foresaw a need for a future loan, rather then taking advantage of the higher yields of less liquid investments. A donor could "donate" cash or property to a foundation and have the foundation lend the money or property to his business. Taking into account the tax deduction for the gift, a donor in the 50 percent bracket could make twice as much available to a business by funneling the cash through the foundation as he could by loaning after-tax cash straight to the business. However, at the time of repayment, the foundation not the donor would get the cash. Another technique found by Treasury was the donation of property to a foundation with the retention of an option to repurchase, thus keeping potential gain available to the donor. Treasury recommended a return to the total prohibitions against self-dealing as contained in the original House bill.

6. *Broadening foundation management.* Treasury recommended limiting donor influence after 25 years of foundation existence. After that time the donor and related parties would not be permitted to constitute more than 25 percent of the governing body of the foundation. Treasury suggested a phase-in for existing foundations. The Department rejected the idea of limiting the life of foundations to a specified period, finding no excessive control of the economy by foundations.

Treasury's additional recommendations included denying charitable contribution deductions for gifts of unproductive property until the foundation sold the property, made it productive, or applied it to a charitable activity; offsetting the deduction for gifts of ordinary income property by the amount of gain which a donor would have realized if the property had been sold; changing the relationship of the estate tax marital deduction and the charitable contribution deduction, and imposing lesser sanctions for failing to file the annual information return when the offense was not criminal in nature.

B. The Tax Reform Act of 1969

Section 110 of the Revenue and Expenditure Control Act of 1968 (P.L. 90-364) directed the President to submit to the Congress proposals for a comprehensive reform of the Internal Revenue Code of 1954 not later than December 31, 1968. By letter to the Speaker of the House of Representatives dated December 31, 1968, President Johnson advised the Congress of the existence of the studies and proposals for tax reform which were developed in the Treasury Department pursuant to the Revenue and Expenditure Control Act of 1968, and of his decision to make no recommendations to the Congress in light of the fact that he would be leaving office on January 20, 1969.[34]

The chairmen of the tax-writing committees requested that the Treasury studies and proposals be submitted to the Congress, and this was done by the new Nixon Administration Treasury staff. The proposals were printed by both tax committees as a joint publication for information purposes.

There was no specific bill before the Committee on Ways and Means when it began its hearings on tax reform in February 1969, and the Treasury proposals served as a basis for discussion in the hearings. Treasury's recommendations in two areas were to affect private foundations:

1. Treasury recommended changes in the charitable contribution deduction. One of these was that persons owning appreciated property not be able to realize a greater after-tax profit by donating the property to a charity than they would by selling the property, paying taxes on the gain, and keeping the proceeds.
2. Treasury recommended that the Congress act on the report on private foundations which Treasury had submitted to the Congress in 1965.

House Hearings and Report

The Committee on Ways and Means held four days of hearings on private foundations with Wright Patman as the lead-off witness.

The Committee hearings concluded on April 25, 1969. H.R. 13270 was introduced on August 1, 1969 by the chairman and the ranking minority member of the Committee.[35] The bill was a major tax reform bill, and two of the 27 groups of tax reforms included reforms of private foundations and changes in the charitable contribution deduction. The Committee on Ways and Means bill contained provisions which (1) defined private foundations, (2) reaffirmed differing tax treatment of contributions to public charities and private foundations, (3) gave the Internal Revenue Service additional tools to gain information about private foundations and public charities; and (4) which established a series of excise taxes on certain activities of private foundations.

The bill was considered under a closed rule and therefore there were no floor amendments to these provisions.

Senate Hearings and Report

When Senate Finance Committee hearings were held on the House bill, most of the testimony on foundations was a reaction to the House bill provisions.[36]

As reported by the Senate Committee on Finance, the bill was substantially similar to the bill passed by the House. There were, however, three major substantive differences. First, the Finance Committee bill contained provisions to limit the life of private foundations to 40 years. Second, the Committee bill included an audit fee of one-fifth of one percent of noncharitable assets of the private foundations to recover the costs of IRS supervision of foundations. The bill also included provisions which limited the income tax deduction for donations of appreciated property to public charities to 30 percent only for the portion attributable to the appreciation, not the portion of attributable to cost.

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[34] U.S. Treasury Department, Tax Reform Studies and Proposals, a joint publication of the House Committee on Ways and Means and the Senate Committee on Finance, 91st Cong., 1st Sess. iii (Comm. Print Feb. 5, 1969).

[35] The bill was referred to the Committee on Ways and Means, 115 Cong. Record 218H (1969), on August 2, 1969 the bill was reported to the House H. Rept. No. 413, 91st Cong., 1st Sess. (1969).

[36] Tax Reform Act of 1969: hearings on H.R. 13270 before the Senate Finance Comm., 91st Cong., 1st Sess., pt. 1, 2, 6 (1969).

On the Senate floor, the private foundation and charitable deduction provisions of H.R. 13270 were amended again. The proposal to limit the life of the tax-exemption for private foundations was deleted on the Senate floor.

The Senate also decreased the proposed audit fee for future years to one-tenth of one percent, increased the minimum payout requirement to six percent, permitted certain private foundations to conduct voter registration drives, and made several other amendments.

The difference between the House and Senate provisions were resolved by a Conference Committee and were contained in the Tax Reform Act of 1969.

Public Law 91-172

In the Tax Reform Act of 1969 (P.L. 91-172), the Congress enacted a series of rules (violations of which trigger excise taxes) that require private foundations to maintain a specified minimum level of charitable expenditures or grants, that limit the extent to which foundations may control business enterprises, and that prohibit foundations from making speculative investments, from making grants to other foundations without exercising expenditure responsibility, and from engaging in "self-dealing" transactions with related persons. In addition, the 1969 Act imposed an excise tax of 4 percent on the net investment income of private foundations, and strengthened prior-law rules for reporting information to the Internal Revenue Service and disclosure to the public.

The 1969 Act generally defined private foundations as all charitable, educational, or religious organizations (including trusts with charitable, etc. beneficiaries) *other than*—

(1) Several categories of organizations which, under prior law, had been eligible for favorable charitable deduction rules. These public charities include certain organizations defined by reference to their nature (such as churches, schools, and hospitals) and others defined by reference to their broad public support or governmental funding (such as the United Givers Fund or publicly supported community centers, museums, libraries, etc.)

(2) An additional category of organizations which receive broad public support in the form of contributions, membership fees, or receipts from admissions, etc. (including publicly supported membership organizations such as PTA associations, scouting groups, etc.).

(3) Organizations formed exclusively to benefit, and which are controlled by or operate in connection with, public charities (such as scholarship trusts operated in connection with a college).

Organizations which fail to qualify under any of these three categories of public charities are classified for tax purposes as either private nonoperating foundations—basically, grantmaking foundations—or as private operating foundations—basically, foundations which themselves directly engage in charitable, etc. functions.

The 1969 Tax Reform Act also modified prior-law rules governing charitable deductions for contributions by individuals to public charities and private foundations.

In general, the 1969 Act retained differing treatment (dating from the 1954 Code and the Revenue Act of 1964) with respect to the percentage limitations applicable for contributions to public charities as compared to contributions to private nonoperating foundations, but extended the more favorable treatment for public charities to private operating foundations. Also, the 1969 Act generally required a reduction (from fair market value) in the amount deductible on contributions of appreciated capital-gain property to private nonoperating foundations, but not in the case of such contributions to public charities or private operating foundations.

C. Post-1969 Legislative Developments

Since 1969, particular provisions of the Internal Revenue Code governing private foundations have been modified, but the basic structure of the rules enacted in 1969 has been retained. Among the most significant changes made since 1969 are (1) the reduction of the excise tax on net investment income from 4 to 2 percent;[37] and (2) changes in the computation and amount of the payout requirement.[38]

1973 and 1974 Hearings

In 1973 the House Committee on Ways and Means conducted a lengthy series of hearings on general tax reform, including two days on private foundations and charitable contribution rules.[39] The following year hearings were held by the Senate Subcommittee on Foundations.[40] During the course of these hearings, witnesses representing foundations and their beneficiaries expressed concern about the 4 percent excise tax on net investment income and the minimum payout requirements of then existing law.

Filer Commission Report

In 1975, the Commission on Private Philanthropy and Public Needs, chaired by John H. Filer, issued its report, Giving in America: Toward a stronger Voluntary Sector. The commission, privately funded and formed in 1973 under the initiative of John D. Rockefeller 3rd and at the encouragement of Wilbur D. Mills and officials of the Department of Treasury, had twin goals to study and make recommendations about philanthropy and philanthropic institutions in the United States. Several of its recommendations anticipated future legislation.

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[37] P.L. No. 95-600, § 520(a), 92 Stat. 2884.

[38] Originally, the minimum payout was the higher of the minimum investment return, or adjusted net income. The variable rate based on a 1969 return rate of 6 percent was changed to a straight 5 percent by Pub. L. No. 94-455, § 1303(a), 90 Stat. 1715. Section 823(a)(1) of the Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 95 Stat. 351, eliminated the alternative use of adjusted net income from the minimum payout requirement so that the present payout is equal to the 5 percent minimum investment return.

[39] General Tax Reform Part 14: Hearings before the House Comm. on Ways and Means, 93rd Cong., 1st Sess. (1973) [hereinafter cited as 1973 Tax Reform Hearings].

[40] Private Foundations: Hearings before the Subcomm. on Foundations of the Senate Comm. on Finance, 93rd Cong., 2nd Session (1974).

Donee Group Report

In response to the Filer Commission report, the Donee Group, a coalition of public interest, social action and volunteer groups acting as advisors to the Commission on Private Philanthropy and Public Needs, put out its own undated report and recommendations. This group had a different perspective on the problems which ought to have been studied and the conclusions which ought to have been reached. The Donee Group criticized the Filer Commission for its desire to preserve the status quo and its excessive confidence in self-regulation, and suggested that the Commission was concerned only with the donors, not the recipients of philanthropy.

The Donee Group recommended, among other things, requiring public membership on boards of foundations; limiting donor control; publicizing information on grants, including amounts, criteria, and recipients; holding annual public meetings of the boards of charities; and fixing the annual payout requirement at 6 percent of the market value of foundation assets, plus one-half of any excess income over that amount.

Tax Reform Act of 1976

Provisions of the 1976 Tax Reform Act addressed a number of issues raised during Congressional hearings on foundations in 1973 and 1974. Contained in the 1976 Act were: (1) modification of the minimum payout requirement to the greater of adjusted net income or 5 percent of the net value of assets, eliminating the fluctuating minimum based on 1969 money rates and investment yields; (2) modification of the law to permit declaratory action by an organization and judicial review of an adverse determination (or failure to make a determination) by the Internal Revenue Service of the organization's exempt status; (3) modification of the transitional rule for sales of leased property owned by private foundations to the lessee (disqualified person), if the foundation receives an amount equal to or greater than fair market value; and (4) modification of transitional rule for sale of excess business holdings to disqualified persons at price equal to or exceeding fair market value to add one year to this transition provision.

Revenue Act of 1978 and other changes

The Revenue Act of 1978 contained two provisions concerning private foundations. First the excise tax on a foundations net income was lowered from 4 to 2 percent. Second, only for purposes of the annual distribution requirements, certain long-term facilities for the care of disabled, elderly, or needy persons would be considered operating foundations, providing they spent at least two-thirds of their investment return in operating the facility.

In 1980, Congress passed three laws which amended some of the private foundation provisions. First, P.L. 96-596 addressed a problem regarding the Tax Court's interpretation of its jurisdiction over second-tier excise taxes.[41] Second, P.L. 96-603 consolidated into one document the annual report and the annual return which were required to be filed by private foundations.[42] Third, P.L. 96-608 contained a special provision exempting certain leases from the taxes on self-dealing.[43]

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[41] P.L. 96-596, 94 Stat. 3469, amending IRC §§ 4941-4952 and others, adding §§ 4961-4962.

Economic Recovery Tax Act of 1981

In the Economic Recovery Tax Act of 1981, Congress made two major provisions regarding private foundations. First, the minimum payout requirement was adjusted so that a foundation was not necessarily required to distribute all of its investment income.[44] The provision required a foundation to annually distribute to charitable beneficials no less than 5 percent of the value of its investment assets. The definition of private operating foundation was also amended in conformity with this change so that a private operating foundation would now be required to spend substantially all of the lesser of its adjusted net income or the minimum investment return, in addition to meeting one of three other tests.[45] Under prior law a private operating foundation had been required to spend substantially all its adjusted net income.

The second provision dealt with charitable contributions. Nonitemizers were allowed a limited above-the-line deduction for a percentage of their charitable contributions.[46] In addition, the limit on corporate charitable contributions was increased from 5 percent to 10 percent of adjusted taxable income.[47]

Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA): Proposed Exceptions to the Excess Business Holdings Provision

During the 97th Congress a number of bills were introduced to provide exceptions to the application of the excess business holdings and divestiture requirements of IRC § 4943. For example, when the Senate Committee on Finance held hearings on October 28, 1981, on Miscellaneous Tax Bills, one of the measures being considered was S. 1745, a measure designed to exempt the El Pomar Foundation from that provision.[48]

Included in the bill reported by the Senate Finance Committee were exemptions from the excess business holding requirement for the El Pomar Foundation and for the Houston Endowment, Inc.[49] Other exemptions were added on the Senate floor. These included: (1) an amendment which exempted the Sands Springs Home and the Otto Bremer Foundation and which provided that a certain type of trust with charitable interests not be treated as a private foundation;[50] (2) an amendment to exempt the Public Welfare

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[42] P.L. 96-603, 94 Stat. 3503, amending IRC §§ 6033, 6104, repealing § 5056.

[43] P.L. 96-608, § 5, 94 Stat. 3553, amending IRC § 4941(d); see S. Rept. No. 1031, 96th Cong., 2d Sess. 14-15 (1980).

[44] 127 Cong. Rec. S8280-S8281 (daily ed. July 23, 1981).

[45] P.L. 97-34, § 823, 95 Stat. 351, amending IRC § 4942(j).

[46] P.L. 97-34, § 121, 95 Stat. 196, adding IRC § 170(i).

[47] P.L. 97-34, § 263, 95 Stat. 264, amending IRC § 170(b)(2).

[48] 1981-82 Miscellaneous Tax Bills, XI, Hearings before the Subcomm. on Taxation and Debt Management of the Senate Comm. on Finance on S. 1035, S. 1595, and S. 1745, 97th Cong., 1st Sess., 48-54 (1981) [hereinafter cited as Hearings on S. 1745]. Because this case is illustrative of the special circumstances request for exemption, it is discussed in more detail in the section on continuing issues dealing with excess business holdings.

[49] S. Rep't. No. 494, 97th Cong., 2d Sess. 400-401 (1982). See S. 2506 and H.R. 6213 (97th Cong.), which were for the benefit of the Houston Endowment.

[50] 128 Cong. Rec. S8917-S8919 (daily ed. July 22, 1982).

Foundation;[51] and (3) a five year extension of the divestiture period for the Ahmanson Foundation.[52]

All of these special exemptions were removed by the Conference Committee, at the insistence of House members, and it was agreed that hearings would be held on the tax treatments of foundations, including present law excess business holdings limitations.[53]

D. Summary of Historical Development

The history of tax treatment of private foundations suggests that the trend over the past 40 years has been to differentiate private grantmaking foundations from public charities and operating (basically nongrantmaking) foundations for a variety of tax purposes, ranging from contribution deductions to regulation of organization and conduct. With respect to charitable contribution deductions, for example, a tax preference for contributions to public charities was first enacted in 1954. Present law retains this tax preference.

The private foundation provisions of the 1969 Tax Reform Act were enacted in light of findings that neither the general requirements for tax-exempt status, nor the specific rules under prior law governing foundation transactions and expenditures, had proved effective to ensure that Federal income tax incentives would be available only where a foundation's assets and income are devoted to charitable, and not private, purposes. Accordingly, since the rationale underlying the deductibility of contributions and tax-exempt status is the encouragement of private giving to carry out charitable programs and activities, the 1969 Act developed additional rules and excise tax sanctions designed to ensure that the expenditures, investments, and transactions of private foundations will be consistent with this underlying rationale for favorable tax treatment.

The lengthy hearings held by the tax-writing committees on the 1969 legislation, the 1965 Treasury report on private foundations, and investigations and hearings conducted from 1962–69 by the House Select Small Business Committee (chaired by Wright Patman) had demonstrated specific instances where prior law had been inadequate to prevent the use of foundations for controlling business enterprises and benefiting substantial contributors at the expense of charitable programs to prevent foundations from denying current benefits to charity through investment in nonproductive assets, or to prevent foundations from making grants without taking responsibility for proper use of the funds for charitable purposes. Also, the prior-law rules, which included prohibitions on unreasonable accumulations of income, and on transactions with related persons if not made on arms's-length terms, lacked specificity and clarity. Finally, the only sanction under prior law for foundation misuse (loss of exempt status) was so severe that the Internal Revenue Service and the courts hesitated to impose it in all but the most egregious cases.

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[51] Id. at S8970–S8971.

[52] Id. at S9012–S9013.

[53] H. Rep't. No. 760, 97th Cong., 2d Sess. at 680–681 (1982); 128 Cong. Rec. S10943 (daily ed. Aug. 20, 1982) (statements of Senator Dole in response to a question as to the conference committee's elimination of the provision for an extension of the divestiture period for the Ahmanson Foundation).

Undoubtedly, the perception of foundations as a potential vehicle for tax abuse was also a contributing factor in the development in 1969 of the definition of a private foundation and the imposition of prohibitions and limits on foundation structure and conduct. While there has been some liberalization of the limitations imposed in 1969, primarily at the behest of private foundations, the general structure of the rules enacted in 1969 remain largely intact.

IV. DEFINITIONS

A. Private Foundation v. Public Charity

Background

Since the Revenue Act of 1950, foundations have been subject to special restrictions on their expenditures, investments, and transactions, as well as to the general requirements and rules applicable to all tax-exempt charitable organziations (e.g., that the organization must be organized and operated exclusively for exempt purposes, as compared with private or business purposes). Similarly, as described supra., the distinction between foundations and public charities for pusposes of the charitable deduction rules dates back to the 1954 Code.

Thus, the 1950 Act prohibitions on transactions with donors or other related persons (unless made on an arm's-length basis), and on unreasonable accumulations of income, applied generally to those charitable organizations defined by the Tax Reform Act of 1969 as private foundations. That is, the 1950 Act prohibitions applied to all tax-exempt charitable organizations other than churches (and certain religious organizations other than trusts), support organizations to churches, schools, hospitals, medical research or medical education organizations, and certain publicly supported organizations.

The 1950 Act provisions were enacted in light of findings by the tax committees, after study of the operations of exempt charitable organizations, which had revealed a number of cases where there had been misuse of foundations, including cases where donors had derived substantial benefits from dealing with foundations. However, the 1950 Act prohibitions were not applied to those organizations (churches, schools, publicly supported organizations, etc.) which "are in general what might be called 'public' organizations and because of this characteristic are not believed likely to become involved in" [1] misuse situations.

Likewise, in defining those charitable organizations subject to the private foundation rules enacted in the 1969 Act, the Congress concluded that in general the problems which necessitated enactment of the new rules would be especially prevalent in the case of private foundations, as compared with organizations as to which there was substantial public involvement in the form of broad public support (whether from contributions, membership fees, or receipts from related activities).[2]

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[1] See Rep. No. 2375, 81st Cong., 2nd Sess. 38 (1950); H.R. Rep. No. 2319, 81st Cong., 2d Sess. 42 (1950).

[2] See, H.R. Rep. No. 91-413 (Pt. 1), *supra* n.3, at 40-41; S. Rep. No. 91-552, *supra* n., at 56-59; General Explanation of 1969 Act, *supra* n.3, at 57-60.

In general

The term "private foundation" was defined in the Tax Reform Act of 1969 by a process of exclusion. That is, any charitable, educational, religious, etc. organization (including a charitable trust) which is described in Code section 501(c)(3) and tax-exempt under section 501(a) constitutes a private foundation, unless the organization establishes that it is excluded from foundation status under one or the three categories of organizations (described below) collectively referred to as public charities.[3]

Section 509(a)(1) organizations

This category of public charities consists of certain organizations defined by reference to their nature—churches, educational institutions (schools, colleges, and universities), certain organizations established to fund State colleges or universities, hospitals, medical research organizations operated in conjunction with hospitals, and governmental units—plus certain organizations defined by reference to their public support. For this purpose, an organization qualifies as publicly supported if it satisfies either a mechanical test or a facts and circumstances test.

Mechanical (one-third) test

To meet the mechanical public support test, the organization must normally receive at least *one-third* of its total support (all receipts except those from related business activities and except for "unusual grants") as qualified grants or contributions. The latter term means the total amount of grants or contributions from section 170(b)(1)(A)(vi) publicly supported charities or from governmental units, plus any contribution received from an individual, trust, or corporation but only to the extent not exceeding two percent of the organization's total support.

Facts and circumstances (10 percent) test

Alternatively, as long as the organization receives at least *ten percent* of its support in the form of such qualified grants or contributions, the organization will be treated as a public charity if it is operated so as to attract new and additional public support on a continuous basis, and if all the pertinent facts and circumstances establish that it is in the nature of a publicly supported organization. The relevant factors include the amount and nature of its support from public or governmental sources, whether it has a governing board representing the broad interests of the public, whether it makes its facilities or services available to the public, whether its membership represents a broad cross section of the interested public, whether it is accountable to a government agency or public charity from which it receives a significant part of its funds, etc.

Community foundations

Community foundations are trusts which are established to attract large contributions of a capital or endowment nature to benefit a particular community or area. Contributions to a community foundation are often received and maintained in the form of separate trusts or funds. The Treasury regulations contain detailed rules indicating when these trusts or funds are to be treated as a single entity (Reg. sec. 1.170A-9(e)(11)). In order for this single entity to be treated as a publicly supported organization, it must satisfy either the mechanical (one-third) test or the facts and circumstances test.

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[3] Also, sec. 501(c)(3) organizations which are organized and operated exclusively for testing for public safety are excluded from private foundation status.

In general, in order to be treated as a component part of a community foundation, a trust or fund must be given to a community foundation and must not be subject to any restriction or condition with respect to the transferred assets. Trusts or funds generally will be treated as part of a single community foundation if: (1) the trusts or funds are commonly known as a community trust, fund, foundation, or similar name; (2) the trusts or funds are subject to a common governing instrument or master agreement; (3) the trusts or funds have a common governing body or distribution committee; (4) the governing instrument permits modification of any restriction on the distribution of funds, and replacement of any trustee for breach of fiduciary duty or for failure to produce a reasonable rate of return; (5) the governing body commits itself to exercise its powers in the best interests of the community and to insure than each trust or fund produces a reasonable rate of return; and (6) the trusts or funds must prepare common periodic reports.

In addition, the Treasury regulations contain more liberal transitional rules for certain community foundations which were in existence before 1976, which allow such community foundations to be treated as publicly supported under the special rules until 1982, and to qualify under the general rules thereafter.

Section 509(a)(2) organizations

Under this mechanical test for public charity status, an organization must normally receive more than one-third of its total support (including contributions, grants, membership fees, gross receipts from related business activities, and gross investment income) from qualified donors in any combination of contributions, grants, membership fees, and certain limited amounts of gross receipts from related activities. The term qualified donors means section 509(a)(1) public charities, governmental units, and persons who are not substantial contributors (and who do not otherwise constitute disqualified persons). In addition, the organization must normally receive not more than one-third of its total support from gross investment income (interest, dividends, etc.).

Section 509(a)(3) organizations

An organization constitutes a public charity under this category if (i) it is organized and operated exclusively for the benefit of, or to carry out the purposes of, one or more designated section 509(a)(1) or section 509(a)(2) public charities; (ii) it is operated, supervised, or controlled by or in connection with one or more such designated public charities; and (iii) it is not controlled by disqualified persons (other than the foundation managers or the designated public charities). These public charities are sometimes referred to as supporting organizations or satellite organizations.

Nonexempt trusts having charitable beneficiaries (Code sec. 4947)

"Split-interest" trusts

If a nonexempt trust has both charitable and noncharitable interests (e.g., in the case of a charitable remainder trust, prior to the death of the income beneficiary), the foundation rules relating to self-dealing and taxable expenditures generally apply with respect to trust amounts for which a charitable deduction was allowed, except for amounts transferred in trust before May 27, 1969 (sec. 4947(a)(2)). However, so long as its status as a "split-interest" trust continues, the trust generally is not subject to the other foundation rules or the two-percent tax on net investment income.

Charitable trusts

If all the unexpired interests in a nonexempt trust are devoted to charitable purposes (e.g., in the case of a charitable remainder trust, after the death of the income beneficiary), and if the trust does not qualify as a public charity, the trust generally is subject to all the private foundation rules and excise taxes (with no exception for amounts transferred in trust before 1969) (sec. 4947(a)(1)). This provision precludes avoidance of the foundation rules merely by organizing as a nonexempt trust rather than as an exempt trust or corporation.

B. Operating v. Nonoperating Foundation

Private foundations are classified by the tax law as either operating—basically, foundations which themselves directly engage in charitable, educational, or religious functions—or nonoperating—basically, grantmaking foundations. The advantages of operating foundation status are:

(1) Contributions to operating foundations are deductible by individual donors to the same extent as contributions to public charities, while contributions to nonoperating foundations (with certain exceptions) receive less favorable treatment.

(2) Foundation grants to operating foundations generally may be counted by the donor foundation as qualifying distributions in satisfaction of the section 4942 payout rules, while grants to nonoperating foundations to not so qualify (with certain exceptions).

(3) Operating foundations are not subject to the section 4942 payout rules (although they must meet certain expenditure requirements to be classified as operating), while all nonoperating foundations are required to satisfy the section 4942 payout rules.

In general, a private operating foundation is defined (sec. 4942(j)(3) as a foundation which expends directly for the active conduct of exempt activities at least 85 percent of the lesser of (a) its adjusted net income or (b) its minimum investment return (i.e., five percent of the value of its investment assets). Also, the foundation must meet one of the three tests relating to its use of assets, operating expenditures, or support.

Under the first test, 65 percent or more of the assets of the foundation must be devoted directly to the active conduct of its charitable activities or to functionally related businesses. Under the second test, the organization must normally spend an amount not less than two-thirds of its minimum investment return directly for the active conduct of its charitable activities. Under the third alternative test, the organization must receive at least 85 percent of its support from five or more exempt organizations and from the general public, and not more than 25 percent of the foundation's support may be received from any one exempt organization.

C. Disqualified Persons

The term "disqualified person" generally includes substantial contributors, foundation officers, directors, or trustees, and members of the family of such an individual, plus certain other related entities (Code sec. 4946). The disqualified family members are the person's spouse, ancestors, and all lineal descendants (and their spouses). The term "substantial contributor" means a person whose contributions to the foundation exceeded two percent of all contributions received by the foundation before the close of the year in which the contribution is made, but only if the person's contributions exceed $5,000 (sec. 5076(d)(2)).

V. SUMMARY OF PRIVATE FOUNDATION RULES: PRESENT LAW AND BACKGROUND

A. Tax on Net Investment Income

Under present law, a two-percent excise tax is imposed on the net investment income of private foundations; i.e., on the sum of gross investment income (including interest and dividends) plus net capital gain, less expenses of earning such income (sec. 4940).

The Tax Reform Act of 1969 imposed a four-percent excise tax on the net investment income of private foundations. The tax was imposed so that foundations would share some of the costs of government, particularly the costs of administering the tax laws relating to exempt organizations. In the Revenue Act of 1978, the Congress reduced the tax rate to two percent, its current rate, noting that the prior rate had produced more than twice the revenue needed to finance administration by the Internal Revenue Service of the exempt organization provisions of the Code.

B. Sanctions to Enforce Foundation Rules

Background

The Tax Reform Act of 1969 established a two-tier system of excise taxes intended to ensure compliance with the private foundation rules set forth in Code sections 4941–4945.

These excise tax sanctions were substituted for the principal penalties imposed under prior law for foundation misuse—loss of the foundation's exempt status and its eligibility to receive deductible contributions. In the case of relatively minor abuses, the prior-law penalties seemed unduly harsh. Moreover, the severity of prior-law penalties resulted in extensive litigation when the Internal Revenue Service sought to impose them in more serious abuse situations, and a noticeable reluctance by the courts to uphold the penalties in any but the most egregious cases.

First-tier sanctions

Under present law, any violation of the foundation rules (secs. 4941–4945) results in imposition of an initial excise tax on the foundation (or in the case of self-dealing, on the disqualified person who entered into the prohibited transaction with the foundation). For example, violation of the prohibitions on self-dealing transactions or jeopardizing investments triggers an excise tax equal to five percent of the amount involved in the self-dealing transaction (sec. 4941) or the jeopardizing investment (sec. 4944), payable for each year (or part thereof) in the taxable period. This means that the tax under section 4941 or 4944 continues to be imposed each year beginning when the prohibited act occurs and ending only when the Internal Revenue Service issues a deficiency notice or assesses tax on the act, or when the prohibited act is "corrected."

In general, the first-tier excise tax on the foundation (or on the disqualified person engaged in self-dealing) applies automatically when a foundation rule is violated, even if the violation in a particular instance could be deemed inadvertent. However, where a foundation fails to satisfy the section 4942 payout requirements solely as a result of an incorrect asset valuation which was due to reasonable cause, the excise tax under that section is excused if the payout deficiency is made up during a specified period.

If there is a violation of the prohibitions on jeopardizing investments, taxable expenditures, or self-dealing, an initial excise tax is imposed on any foundation officer, director, trustee, or responsible employee who knowingly participated in the prohibited act, unless the manager had reasonable cause to excuse participation in the act. This first-level tax on the manager cannot exceed $5,000 ($10,000 in the case of self-dealing) for any one such violation.

Second-tier sanctions

If a violation of the foundation rules (secs. 4941–4945) is not "corrected" within a specified period, an additional excise tax is imposed on the foundation (or in the case of self-dealing, on the disqualified person). For example, a second-tier tax equal to 200 percent of the amount involved in a self-dealing transaction would be imposed on the disqualified person unless (1) the prohibited transaction is undone to the extent possible and (2) the foundation is placed in a financial position not worse than it would be had the disqualified person dealt with the foundation under the highest fiduciary standards.

Similarly, an additional excise tax is imposed on a foundation manager who refuses to agree to correct a violation of the prohibitions on self-dealing, jeopardizing investments, or taxable expenditures. The second-tier tax on the manager cannot exceed $10,000 for any one such violation.

Additional penalties

If a foundation rule violation is willful and flagrant,[1] or if there has been a prior violation of any foundation rule, the excise tax sanctions are doubled, unless the violation was due to reasonable cause (sec. 6684). In addition, a termination tax (sec. 507) may be imposed on the foundation if the violation was willful and flagrant or there have been "willful repeated"[2] violations.

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[1] An act or failure to act violating a foundation rule is deemed willful and flagrant if it is "voluntarily, consciously, and knowingly" committed in violation of any said rule and if it "appears to a reasonable man to be a gross violation * * *" (Treas. Regs. sec. 1.507-1(c)(2)). No motive to avoid the foundation restrictions is necessary to make an act or failure to act willful. However, an act or failure to act is not willful if the foundaiton (or a manager, if applicable) does not know that it is an act to which the foundation rules apply (Treas. Regs. sec. 1.507-1(c)(5)).

[2] For this purpose, the term willful repeated violations means at least two acts or failures to act both of which are "voluntary, conscious, and intentional" (Treas. Regs. sec. 1.507-1(c)(1)).

C. Mandatory Payout Rules

Background

Under a provision enacted in the Revenue Act of 1950, certain charitable organizations (generally corresponding to private foundations as defined by the Tax Reform Act of 1969) would lose their tax-exempt status if the organization's aggregate accumulated income was "unreasonable in amount or duration" in order for the organization to carry out its charitable functions.

In substituting the payout rules in the 1969 Act for this prohibition on unreasonable income accumulations, the Congress found that the prior-law restriction had been defective in two respects.[3]

First, the prohibition on unreasonable income accumulations failed to preclude private foundations from holding or investing in assets which produced no current income, such as undeveloped land. As a result, while the donor to the foundation would receive an immediate charitable deduction on making a gift of nonproductive assets (or of property converted into such assets by the foundation), there could be an indefinite delay between the loss of tax revenues from allowing the deduction and the benefit intended to accrue to the public from having an equivalent amount of funds devoted by the donee foundation to charitable programs.

Second, the prohibition on unreasonable income accumulations was difficult to enforce both because of its vagueness and the essentially subjective nature of the test, and because the prior-law sanction (loss of exempt status) was either unduly harsh for minor violations or largely ineffective for more substantial violations. Some court cases under the prior-law restriction had been interpreted as sanctioning accumulations of income for up to 10 years for the sole purpose of increasing the size of the foundation's corpus.[4]

The Tax Reform Act of 1969 in effect required private nonoperating (grantmaking) foundations to make payouts at a specified minimum level, either (1) as direct expenditures to accomplish charitable purposes (including administrative expenses paid for such purposes) or (2) as grants to public charities or private operating foundations. (Grants to private nonoperating foundations generally do not count as qualifying distributions, nor do grants to an organization controlled by the donor foundation or its disqualified persons.) If certain requirements are met (including, in certain cases, advance approval from the Internal Revenue Service), a foundation may count as current distributions amounts "set aside" to be paid within five years for a specific project.

As enacted in 1969, the payout provision required foundations to make qualifying distributions equal to the higher of (1) the foundation's net income (other than long-term capital gains) or (2) the foundation's minimum investment return—then set at six percent of the fair market value of the foundation's investment assets, with that rate subject to certain adjustments for post-1970 years. The Tax Reform Act of 1976 substituted a flat five-percent rate for measuring the minimum investment return. In 1981, the Economic Recovery Tax Act repealed the prior-law rule that had required foundations to distribute any excess of net income over the minimum investment return, on the ground that because of then high inflation rates, the income distribution requirement could result in significant erosion of the real value of foundation endowments.

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[3] See H.R. Rep. No. 91-413 (Pt. 1), 91st Cong., 1st Sess. 25-27 (1969); S. Rep. No. 91-552, 91st Cong., 1st Sess. 34-38 (1969); Staff of the Joint Committee on Taxation, "General Explanation of the Tax Reform Act of 1969" 36-40 (Comm. Print 1970) (hereinafter cited as "General Explanation of 1969 Act"); "Treasury Department Report on Private Foundations," House Committee on Ways and Means, 89th Cong., 1st Sess. 23-30, 58-60, 92-96 (Comm. Print 1965) (hereinafter cited as "1965 Treasury Report").

[4] See 1965 Treasury Report, *supra* N. 3, at 26.

Present law (Code Sec. 4942)

Under present law, a private nonoperating foundation must make qualifying distributions, by the end of the following year, at least equal to five percent of the value of its investment assets for the year (less the amount of sec. 4940 tax on the foundation's net investment income for the year). Violations of the mandatory payout rules triggers an excise tax levied on the foundation. Under a special rule, a foundation is excused from the excise tax sanction if insufficient distributions resulted from an incorrect valuation of assets which was due to reasonable cause, and the payout deficiency is made up during a specified period.

The payout rules under section 4942 do not apply to private operating foundations. However, to qualify for operating status, a private foundation must meet certain payout requirements (see Part IV.)

D. Limitations on Business Holdings

Background

Prior to the Tax Reform Act of 1969, there were no specific provisions that dealt with ownership of businesses by charitable organizations, including private foundations. However, in some cases, the courts held that an organization lost its tax-exempt status where the business activities predominated over the charitable activities of the organization.

The Tax Reform Act of 1969 in effect generally limited the combined ownership of a business corporation by a private foundation and disqualified persons. In 1969, the Congress found that a number of private foundations were being used to maintain control of businesses. This result was possible because prior law was not sufficiently clear on how much business activity would disqualify an organization from exempt status, and because courts were reluctant to deny exempt status for having such holdings.

In addition, the Congress was concerned that foundations which owned large holdings in a business tended to be relatively unconcerned about producing income, that the attention and interest of such organizations would be devoted to the operation, maintenance, and improvement of the business while neglecting exempt activities, and that businesses owned by exempt organizations may be operated in a way that provides those businesses with a competitive advantage over businesses owned by taxable persons. In general, the Congress concluded that a private foundation should be limited in the amount of a business which it may control.[5]

The 1969 Act provided special rules applicable where the business holdings of a private foundation (combined with disqualified persons) exceeded certain percentage limitations on May 26, 1969 (so called "grandfathered holdings"). These special rules also apply to holdings acquired under trusts irrevocable on that date, or certain wills executed by that date, even though the actual transfer to the foundation occurs later. In general, grandfathered holdings are permitted to be retained, but are subject to gradual reduction.

Present law (Code sec. 4943)

Post-1969 holdings

Under present law, the combined ownership of a business enterprise by a private foundation and disqualified persons (for this purpose, including certain related foundations) may not exceed 20 percent of the stock of the business.[6] (For example, if the disqualified person's holdings are five percent, the foundation itself may hold only 15 percent.) If persons other than disqualified persons have effective control of the corporation, the combined foundation/disqualified person holdings are limited to 35 percent. A private foundation may not conduct any business as a proprietorship.

Under a *de minimis* rule, there are no excess business holdings if a private foundation (together with related foundations) owns not more than two percent of the voting stock and not more than two percent of the value of all classes of stock, regardless of the extent of ownership by disqualified persons. Also, there are no percentage limitations on foundation ownership of a business which is functionally related to the foundation's charitable programs, or of a business deriving 95 percent of its gross income from certain passive sources.

Holdings in excess of permitted limits which are acquired after May 26, 1969 by gift or bequest must be disposed of by the foundation within five years after acquisition. Post-May 26, 1969 purchases of stock by a foundation or a disqualified person which create or increase aggregate holdings beyond permitted limits do not qualify for the five-year grace period, and may immediately result in excise tax penalties on the foundation (subject to a 90-day grace period for a foundation to reduce its holdings as required after purchases by a disqualified person). Under a so-called "downward ratchet" rule, if a private foundation must reduce its holdings because of purchases by disqualified persons which make the combined holdings exceed the applicable percentage limitation, the foundation cannot thereafter acquire more stock to restore its holdings to the former level (unless the combined holdings after such acquisition by the foundation do not exceed 20 percent).

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[5] See H.R. Rep. No. 91-413 (Pt. 1), *supra* n.3, at 27-31; S. Rep. No. 91-552, *supra* n.3, at 38-45; General Explanation of 1969 Act, *supra* n.3, at 40-46; 1965 Treasury Report, *supra* n.3, at 30-45, 96-99.

[6] If all disqualifed persons together do not own more than 20 percent of the voting stock of a corporation, there is no limit on the nonvoting stock which may be held by the private foundation.

To determine permitted holdings in a partnership, the foundation's "profits interest" is aggregated with the profits interests of all disqualified persons and substituted for the voting stock limitation applicable to corporations, and "capital interest" is used in place of nonvoting stock.

In computing the holdings of any business enterprise, stock or other interests owned, directly or indirectly, by a corporation, partnership, estate, or trust are considered as owned proportionately by the beneficial owners.

Grandfathered holdings

Under present law there are special rules applicable where the business holdings of a private foundation (combined with disqualified persons) exceeded the 20-percent/35-percent limitation on May 26, 1969. These special rules also apply to holdings acquired under trusts irrevocable on that date, or certain wills executed by that date, even though the actual transfer to the foundation occurs later. In general, grandfathered holdings are permitted to be retained, but are subject to gradual reduction.

If, on May 26, 1969, the combined holdings of the foundation and disqualified persons exceeded 50 percent, the holdings are to be reduced over several phases. Under the first phase, by the deadlines shown below the combined foundation/disqualified persons holdings cannot exceed 50 percent of the voting stock of the corporation or, if less, 50 percent of the value of all outstanding shares—

Ownership on 5/26/69:	*Deadline to reach 50% combined holdings:*
More than 95% by foundation alone.	May 26, 1989
More than 75% combined holdings.	May 26, 1984
More than 50% combined holdings.	May 26, 1979

After expiration of the first phase, a second set of divestiture requirements becomes operational. If disqualified persons do not own more than two percent of the corporate voting stock at any time during the 15 years after the close of the first phase, the combined foundation/disqualified person holdings must be reduced to not more than 35 percent by the end of that period (i.e., for a foundation which itself owned 95 percent of the stock on May 26, 1969, by May 26, 2004); the foundation itself cannot hold more than 25 percent if disqualified person ownership exceeds two percent. If disqualified persons own more than two percent of the corporate voting stock at any time after the close of the first phase, the combined holdings may continue up to 50 percent without reduction, except that the voting stock held by the foundation must be reduced to 25 percent at such time beginning with the close of the first phase as disqualified person ownership exceeds two percent.

Where May 26, 1969 aggregate holdings did not exceed 50 percent, a further decrease generally will not be required if foundation holdings never exceed 25 percent.

Grandfathered holdings are subject to reduction by operation of the "downward ratchet" rule. The rule, in effect, provides that if there is any increase in the holdings of disqualified persons, the holdings of the foundation must be decreased accordingly and can never go up again to the former grandfathered or otherwise permitted level over 20 percent (or 35 percent, if applicable), even if the holdings of disqualified persons are thereafter reduced.

E. Prohibition on Jeopardizing Investments

Background

Under the law prior to the Tax Reform Act of 1969, a private foundation would lose its tax-exempt status if its accumulated income was invested in a manner which jeopardized the carrying out of its charitable purposes.

In 1969, the Congress found that the prior law rules were defective in two respects.[7] First, the prior law rule applied only to investments of accumulated income; it did not apply to investments of corpus. The Congress believed that investments of corpus which jeopardize carrying out of exempt purposes may reduce benefits to charity just as much as jeopardizing investments of accumulated income. In addition, the loss of exemption was too harsh a sanction, and a more objective and limited sanction was needed.

Present law (Code sec. 4944)

Present law in effect prohibits a private foundation from making investments of income or principal which would jeopardize carrying out its charitable purposes. Certain program-related investments, such as in low-income housing programs, are deemed not to violate this prohibition where the investment does not have a significant purpose of making profit.

Under this rule, foundation managers must exercise ordinary business care and prudence, as determined at the time of the investment, in providing for the long-term and short-term needs of the foundation in carrying out its exempt purposes. No category of investments is per se prohibited, and the standard of care and prudence is applied by taking into account the foundation's portfolio as a whole (Treas. Reg. sec. 53.4944-1(a)(2)).

F. Restrictions on Foundation Expenditures

Background

Since 1934, the Code has provided that no substantial part of the activities of an exempt charitable, educational, etc., organization may consist of carrying on propaganda or otherwise attempting to influence legislation. In addition, such organizations may not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office. Finally, a charitable, etc., organization would lose its exempt status if its accumulated income was used to a substantial degree for purposes other than its exempt purposes.

In 1969, the Congress found that these prior-law rules were defective in several respects.[8] First, denial of exempt status was a harsh sanction for violation of these rules, especially since the standards on permissible levels of prohibited activities were imprecise. Second, because of the substantiality test, large foundations could engage in significant amounts of lobbying. Third, the law was unclear as to whether certain activities, such as voter registration campaigns and publication of the views, personalities, and activities of candidates, constituted prohibited activities. Finally, the Congress was concerned that some grants by foundations were not being used for charitable purposes, but instead were being used for such purposes as vacations or to subsidize the preparation of material furthering political viewpoints. The Congress also concluded that private foundations should take substantial responsibility for the proper use of grants they make.

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[7] See H.R. Rep. No. 91-413 (Pt. 1), *supra* n.3, at 31; S. Rep. No. 91-552, *supra* n.3, at 45-46; General Explanation of 1969 Act, *supra* n.3, at 46-47; 1965 Treasury Report, *supra* n.3, at 52-54.

[8] See H.R. Rep. No. 91-413 (Pt. 1), *supra* n.3, at 31-35; S. Rep. No. 91-552, *supra* n.3, at 46-51; General Explanation of 1969 Act, *supra* n.3, at 47-52.

Present law (Code sec. 4945)

In general

Present law in effect prohibits private foundations from making expenditures for grassroots or direct lobbying, for political campaigns (subject to a narrow exception for certain nonpartisan voter registration drives), or for any noncharitable purpose. In addition, present law in effect places limitations on foundation grants to individuals or to organizations other than public charities.

Grants to individuals

In the case of grants to individuals, the foundation must obtain advance approval from the Internal Revenue Service of its grantmaking procedure (but not of specific awards). In addition, the grant must be made on an objective and nondiscriminatory basis, and must either (1) constitute a scholarship or fellowship excludable from the grantee's income under section 117(a), and be used for study at an educational institution; (2) constitute a nontaxable prize or award (as defined in sec. 74(b)); or (3) be made to "achieve a specific objective, produce a report or other similar product" or improve or enhance a capacity, skill, or talent of the grantee.

Grants to organizations

In general.—In the case of grants to organizations other than public charities, the private foundation must exercise "expenditure responsibility" over the grant. To ensure that such grants will be properly used by the recipient for charitable purposes, the grantor must make reasonable efforts, and establish adequate procedures, to see that the grant is spent solely for proper uses, to obtain full reports from the grantee, and to make full reports to the Internal Revenue Service on the grants. There is no exception in present law from the expenditure responsibility requirements for grants below a specified dollar amount.

Regulatory guidelines.—Treasury regulations expressly state that the expenditure responsibility rules do not make donor foundations insurers or guarantors of the activities of donee organizations, and set forth guidelines under which donor foundations may satisfy the section 4945 rules (Reg. sec. 53.4945-5(b)). For example, the regulations state that a private foundation considering a grant request should conduct a limited inquiry concerning the potential donee, complete enough to give a reasonable person assurance that the grant would be used for charitable purposes. The scope of the inquiry would vary with factors such as the dollar amount of the grant. No such pre-grant inquiry would be required if the donee organization had received prior grants from the donor foundation and had submitted to the donor the required reports substantiating proper use of the earlier grant funds.

The donor foundation must obtain a written commitment from the donee foundation that the latter will use the grant funds solely for charitable purposes and will submit reports as to whether the funds have been used in compliance with the grant terms. The grantor foundation need not conduct any independent verification of such reports unless it has reason to doubt their accuracy or reliability (Reg. sec. 53.4945-5(c)(1)). In meeting its own reporting requirements to the Internal Revenue Service, the grantor foundation may rely on statements from the donee organization or other records showing the information which the grantor, in turn, must report to the Service (Treas. Reg. sec. 53.4945-5(c)(4)).

Reliance on IRS classification.—As noted, the expenditure responsibility rules do not apply to grants to public charities, including publicly supported charitable organizations. Under Treasury regulations, once an organization has been classified as publicly supported, the determination of whether a grant is subject to the expenditure responsibility requirements generally will not be affected by the donee's subsequent loss of classification as a publicly supported organization until notice of loss of classification is published.

However, a donor foundation may not rely on the donee organization's classification if the donor foundation is responsible for or aware of a "substantial and material" change in the donee organization's sources of support that results in the organization's loss of classification as a publicly supported organization. In general, the donor foundation will not be considered responsible for or aware of such a change in support (and hence may rely on a published classification) if the grant is made in reliance on a detailed written statement by the grantee organization that the grant will not result in loss of public charity status, and the information in such statement would not give rise to a reasonable doubt as to the effect of the grant (Treas. Reg. sec. 1.509(a)-3(c)).

To faciliate reliance on published classifications, the Internal Revenue Service has issued guidelines specifying circumstances under which a donor foundation will not be considered responsible for a "substantial and material" change in support of the donee organization.[9] In addition, the Internal Revenue Service has published guidelines specifying circumstances under which a grant will be considered "unusual" and hence will not cause the donee organization to lose its status as publicly supported.[10]

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[9] Under these guidelines, a donor organization generally will not be considered responsible for a substantial and material change in support if the aggregate of gifts, grants, and contributions received from the donor organization for a taxable year does not exceed 25 percent of the aggregate support received by the donee organization from all other sources for the four taxable years immediately preceding the year of the grant (Rev. Proc. 81-6, 1981-1 C.B. 620). In such circumstances, the donor foundation can rely on the classification of the donee organization as publicly supported without risk that its grant will later be treated as causing the donee organization to lose its public charity status (thereby subjecting the donor foundation to excise tax penalties for failure to exercise expenditure responsibility).

[10] Under these guidelines, a grant generally will be considered unusual where six conditions are met: (1) the grant is not made by a donor foundation which created the donee organization or was a substantial contributor to the donee organization; (2) the grant is not made by a donor organization which is in a position of authority to the donee organization; (3) the grant is made in cash, readily marketable securities, or assets that directly further the exempt purpose of the

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G. Prohibition on Self-Dealing

Background

Under a provision enacted in the Revenue Act of 1950, certain charitable organizations (generally corresponding to private foundations as defined by the 1969 Act) would lose their tax-exempt status for at least one year (and, in certain circumstances, eligibility to receive tax-deductible contributions) if the foundation engaged in certain "prohibited transactions" with related persons other than on an arm's-length basis.

The prior-law sanctions applied if a foundation—

(1) lent any part of its income or corpus, without the receipt of adequate security and a reasonable rate of interest, to;

(2) paid any compensation, in excess of a reasonable allowance for salaries or other compensation for personal services actually rendered, to;

(3) made any part of its services available on a preferential basis to;

(4) made any substantial purchase of securities or any other property, for more than adequate consideration in money or money's worth, from;

(5) sold any substantial part of its securities or other property, for less than an adequate consideration in money or money's worth to; or

(6) engaged in any other transaction which results in a substantial diversion of its income or corpus to—

the creator of the organization (if a trust); a person who had made a substantial contribution to such organization; a member of the family of an individual who was the creator of such trust or who had made a substantial contribution to such organization; or a corporation controlled by such creator or person through the ownership, directly or indirectly, of 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock of the corporation.

In substituting the self-dealing prohibitions in the Tax Reform Act of 1969 for the arm's-length standards of prior law, the Congress found the previous rules to be defective in several respects.[11]

First, the Congress concluded that, as a practical matter, prior law had failed to preserve the integrity of private foundations. In some instances, the prior-law sanctions seemed so harsh in comparison to the offense involved that they caused reluctance in enforcement, especially in view of the element of subjectivity in applying arm's-length standards. Where the Internal Revenue Service sought to apply sanctions in such circumstances, the same factors encouraged extensive litigation and a noticeable reluctance by the courts to uphold severe sanctions.

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donee organization; (4) the donee organization has received an advance or final ruling that it is classified as a publicly supported organization; (5) there are no material restrictions imposed on the grant; and (6) if the grant is intended to pay for the operating expenses of the donee organization, the grant is expressly limited to one year's operating expenses (Rev. Proc. 81-7, 1981-1 C.B. 621).

[11] See H.R. Rep. No. 91-413 (Pt. 1), *supra* n.3, at 20-24; S. Rep. No. 91-552, *supra* n.3, at 28-34, General Explanation of 1969 Act, *supra* n.3, at 30-36; 1965 Treasury Report, *supra* n.3, at 15-23, 45-52, 88-92.

Also, the Congress concluded that compliance with arm's-length standards often did not in itself prevent the use of a private foundation to benefit improperly those who control it. This is true, for example, where a foundation (1) purchases property from a substantial donor at a fair price, but does so in order to provide funds to the donor who needs cash and cannot find a ready buyer; (2) lends money to the donor with adequate security and at a reasonable rate of interest, but at a time when the money market is too tight for the donor to readily find alternate sources of funds; or (3) makes commitments to lease property from the donor at a fair rental when the donor needs such advance leases in order to secure financing for construction or acquisition of the property.

Accordingly, to minimize the need to apply subjective arm's-length standards, to avoid the temptation to misuse private foundations for noncharitable purposes, to provide a more rational relationship between sanctions and improper acts, and to make it more practical to properly enforce the law, the 1969 Act generally prohibited self-dealing transactions. This was based on the conclusion by the Congress that the highest fiduciary standards require complete elimination of all self-dealing, rather than merely imposition of arm's-length standards.

Present law (Code sec. 4941)

In general, present law in effect prohibits private foundations from engaging with disqualified persons in any of the following transactions—

(1) A sale, exchange, or lease of property;

(2) Lending of money or other extension of credit, except a loan by a disqualified person to a foundation without interest where the proceeds of the loan are used exclusively by the foundation in pursuit of its exempt purposes;

(3) Furnishing of goods, services, or facilities, except (a) where the goods, services, or facilities are funished by the disqualified person without charge and used by the foundation in pursuit of its exempt purposes; or (b) where the furnishing by the private foundation to the disqualified person is on a basis no more favorable than that on which such items are made available to the general public;

(4) Payment of compensation (or reimbursement of expenses) by the foundation to a disqualified person, except for personal services which are reasonable and necessary for carrying out the exempt purposes of the foundation and the payment is not excessive;

(5) Transfer to, or use for the benefit of, a disqualified person of the income or assets of the foundation; and

(6) Payments to government officials, subject to certain exceptions (e.g., scholarships, prizes, and awards).

For purposes of the self-dealing rules, the term "disqualified person" generally includes substantial contributors, foundation officers, directors, or trustees, and members of the family of such individuals, plus certain other related entities and government officials (sec. 4946). The disqualified family members are the person's spouse, ancestors, and all lineal descendants (and their spouses). The term "substantial contributor" means a person whose contributions to the foundation exceeded two percent of all contributions received by the foundation before the close of the year in which the particular contribution is made, but only if the person's contributions exceed $5,000 (sec. 507(d)(2)).

H. Information Reporting and Public Disclosure Requirements

Background

Under the Revenue Act of 1943, certain tax-exempt organizations were required to file annual returns with the Internal Revenue Service listing their gross income, receipts, and disbursements. This annual return requirement did not apply to religious organizations, schools, certain fraternal organizations, publicly supported charities, and certain government corporations (i.e., generally those organizations that are not private foundations as defined by the 1969 Act).

In 1950, the annual return requirement was expanded to require listing gross income, expenses, disbursements for exempt purposes, accumulations, balance sheet, and the total amount of contributions and gifts received during the year. (These returns were in addition to any returns for unrelated business taxable income returns.) The information required to be furnished on the annual return was open to the public.

No specific sanctions were provided for failure to file an exempt organization return. However, certain criminal provisions could be applied in extreme cases.

In making several changes to these annual filing and disclosure requirements in the Tax Reform Act of 1969 and subsequent legislation, the Congress concluded that the experience of the prior two decades had indicated that additional information was needed on a more current basis from all types of exempt organizations, and that this information should be made available more readily to the public, including State officials.[12] (Under State law, the Attorney General may have certain supervisory and enforcement powers over foundations and other charitable organizations.) Consequently, the 1969 Act applied expanded reporting requirements to all exempt organizations and, particularly, to private foundations.

Present law

Annual returns (Code sec. 6033(b))

With certain exceptions (e.g., for churches), every exempt organization must file an annual information return. The annual return requirement for a private foundation is satisfied by the filing of Form 990-PF, which includes the following information for the taxable year: gross income and related expenses, disbursements, a balance sheet showing assets, liabilities, and net worth, total contributions and gifts received, the names and addresses of all substantial contributors, the names and addresses of the foundation managers and highly compensated employees, and the compensation and other payments made to the foundation managers and highly compensated employees. A copy of the return filed with the Internal

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[12] See H.R. Rep. No. 91-413 (Pt. 1) *supra* n.3 at 36-37; S. Rep. No. 91-552, *supra* n.3 at 52-53; General Explanation of 1969 Act, *supra* n.3, at 52-54; 1965 Treasury Report, *supra* n.3 at 64, 109-110.

Revenue Service must be furnished by the foundation to the Attorney General (or other official) in the relevent State.

The failure to file a timely exempt organization information return (unless reasonable cause is shown) results in a sanction of $10 per day, up to a maximum of $5,000 as to any one return, imposed on the organization (sec. 6652(d)). Failure to file a return after a reasonable demand by the Internal Revenue Service (unless reasonable cause is shown) results in an additional sanction of $10 a day, up to a maximum of $5,000 as to any one return, imposed on the exempt organization officer or employee who fails to file the information return.

Annual reports (Code sec. 6033(c))

The 1969 Act provided that every private foundation with at least $5,000 of assets at any time during the year was required to file an annual report in addition to the annual return. The principal additional information items required in the annual report (Form 990-AR) were the following: (1) itemized lists of assets showing book and market values; (2) itemized lists of grants, amounts, and purposes thereof, grantee names, addresses, and relationship to foundation managers or substantial contributors; and (3) lists of all foundation managers who are substantial contributors or who own at least 10 percent of any corporation, partnership, or other entity in which the foundation owns at least 10 percent.

For taxable years beginning after 1980, private foundations are no longer required to file a separate annual report. However, the information that was required to be filed on the annual report has been incorporated into the annual information return for private foundations (Form 990-PF). Also, the return currently requests certain information regarding applications for grants from the foundation (name, address, and telephone number of the person to whom applications should be addressed; any required format, information, and materials; deadlines for submitting applications and any limitations on the types of awards which the foundation makes, such as by geographical areas, charitable fields, kinds of donee institutions, etc.).

Disclosure requirements (Code sec. 6104)

Under present law, all information required to be furnished on the private foundation annual return, including the names and addresses of any substantial contributor, must be made available to the public by the Internal Revenue Service. In addition, a copy of the private foundation annual return must be made available, at the principal office of the foundation, to any citizen who requests to inspect the return within 180 days after a notice of availability has been published. This notification must be published in a newspaper with general circulation, in the county in which the foundation's principal office is located, not later than the due date for filing the return.

Finally, the Internal Revenue Service is required to notify the Attorney General (or other official) of the relevant State in the event of (1) denial of tax-exempt status to an organization, (2) the operation of a charitable organization in a manner which fails to meet the requirements for tax-exempt status, or (3) the mailing of a notice of deficiency regarding taxes imposed on private foundations. In addition, the Service is to make available to such State officials information about the preceding items that are relevant to any determination under State law.

VI. SUMMARY OF CHARITABLE DEDUCTION RULES: PRESENT LAW AND BACKGROUND

Background

Since the 1954 Code, the income tax treatment of contributions to private foundations generally has been less favorable than the treatment of contributions to public charities. Thus, deductions up to an additional 10 percent of adjusted gross income are allowed for contributions to churches, schools, and hospitals (1954 Code), medical research organizations operating in conjunction with hospitals (P.L. 1022, 1956), organizations supporting State universities (P.L. 87-858, 1962), and publicly supported organizations (Revenue Act of 1964).

In providing (under prior law) an additional 10 percent limitation on deducting contributions to public charities while retaining the 20 percent limitation on deducting contributions to foundations, the tax-writing committees drew this distinction on the grounds that there may be delays (in some instances, for extended periods) in redistributions by foundations of contributed funds to operating charitable organizations or programs. The additional incentive for contributions to public charities was intended "to encourage immediately spendable receipts of contributions" for charity,[1] so that the donated funds for which the special tax incentive was allowed would more promptly reach the ultimate beneficiaries.

Consistently with this underlying objective, the 1969 Act extended favorable tax treatment (e.g., the present-law 50 percent limitation) to private operating foundations—i.e., foundations which expend their funds directly in charitable programs, rather than making grants to other organizations for the latter to then apply to charitable uses. In addition, the only two types of private nonoperating foundations made eligible for the more favorable treatment are organizations which redistribute, within specified periods, all contributions received to public charities or operating foundations.

The 1969 Tax Reform Act modified prior-law rules governing charitable deductions for contributions by individuals to public charities and private foundations.[2] In general, the 1969 Act retained the differing treatment (dating from the 1954 Code and the Revenue Act of 1964) of contributions to public charities and contributions to private nonoperating foundations, but extended the more favorable treatment for public charities to private operating foundations.

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[1] H.R. Rpt. No. 749, 88th Cong., 1st Sess. 53 (1963); S. Rpt. No. 830, 88th Cong., 2d Sess. 58 (1964).

[2] See H.R. Rep. No. 91-413 (Pt. 1), *supra* n.3, at 51-56; S. Rep. No. 91-552 *supra* n.3, at 77-82; General Explanation of 1969 Act, *supra* n.3, at 75-79; 1965 Treasury Report, *supra* n.3, at 58-63.

Present law (Code sec. 170)

Percentage limitations

Under present law, the maximum amount which an individual may deduct in one year is 50 percent of the donor's adjusted gross income for contributions (other than of capital-gain property) to public charities, and 50 percent for contributions to private operating foundations. The 50-percent limitation applies to private nonoperating foundations only if they either redistribute all contributions within a specified period after receipt or qualify as a "pooled fund" foundation. For contributions of capital-gain property to organizations otherwise qualifying for the 50-percent limitation, the limitation generally is 30 percent. In the case of all private nonoperating foundations other than the two categories eligible for the 50-percent/30-percent limitations, present law retains the lower percentage (20 percent) which has been generally applicable to private foundations since the 1954 Code.

Amounts in excess of the 50-percent/30-percent limitations may be carried forward and deducted over the following five years (subject to applicable percentage limitations in those years). There is no carryover of excess deduction amounts where the 20-percent limitation applies.

Contributions of appreciated property

Under present law, in the case of donations by individuals of capital-gain property to private nonoperating foundations where the 20-percent limitation applies, the amount deductible equals the asset's fair market value reduced by 40 percent of the unrealized appreciation, i.e., of the amount by which the value exceeds the donor's basis in the property to public charities, etc., where the 30 percent limitation applies, there is no reduction from fair market value.

Also, under present law there are certain reductions in the deductible amount for contributions of donated ordinary-income property, or of tangible personal property (such as art works) if use by the donee of the property is unrelated to its exempt purposes, whether such property is contributed to a public charity or a private foundation.

VII. GENERAL FINDINGS

Private philanthropy is an essential and integral part of American society. Private foundations are a unique and valuable component of private philanthropic efforts. They are uniquely qualified to initiate thought and action, experiment with new and untried ventures, act flexibly, and assist a variety of charitable endeavors.

Foundations, reflecting the concerns, interests, and experiences of their creators, have increased the diversity of American charitable activities. As pointed out by the Treasury Department in its 1965 report, they provide substantial gifts to major cultural, educational, civic, research, and other organizations, and foundation resources are available to individuals or small groups.

However, the very features that afford private foundations a special role in philantrophy (i.e., tax-exempt status, influence of a small number of people, the presence of uncommitted funds, etc.) in the past created the perception that foundations could be a potential vehicle for tax abuse through the use of foundation resources for private and not public purposes.

It was the occurrence of serious abuses among a minority of foundations, documented persuasively by the Treasury Department in its 1965 report on foundations, that brought about the rules enacted in the Tax Reform Act of 1969. With certain modifications, these rules remain largely intact today. The objective of these tax rules was to ensure that foundations which receive the benefits of tax exemption and eligibility to receive deductible contributions operate strictly in the public interest.

The Subcommittee believes, in general, that the private foundation provisions in the 1969 Act have proved to be fair and effective in ensuring that charitable funds are devoted to charitable purposes. The law is working and working well. Compliance is high. Suspicions and instances of abuse that were prevalent in the years prior to the 1969 Act have substantially decreased, if not disappeared, and that is due to the fact that the restrictions contained in current law are in place and are enforced.

The years since the 1969 Act have been ones of reaffirmation and measured growth of private foundations. Initially greeted by private foundations with great dismay, today the majority of foundations support the essential structure of present-law rules. Foundations have learned not only to live with them, but to view their benefits as helpful in keeping the field free from those whose motives may not be primarily charitable.

In essence, current law provides a delicate balance between effective regulation and the burdens such regulation imposes on foundations and their managers. The Subcommittee believes there is a continuing need for appropriate safeguards to prevent possible abuse and to maintain the public trust and confidence that now exists concerning foundation affairs generally.

The Subcommittee finds that while the basic structure of present-law tax rules applicable to foundations should not be substantially modified, some refinements are warranted in light of thirteen years of experience to remove unnecessary or unduly burdensome restrictions that serve not to encourage but rather impede charitable activities.

Foundations are concerned about meeting the continuing needs of their communities. The years since 1969 have seen foundations reaching out to grantees as well as to each other through such beneficial organizations as the regional associations of foundations and the Council on Foundations. However, it is far beyond the limits of private foundations to fill the gaps created by recent cutbacks in Federal spending. Private foundations cannot replace Government services. Foundations are seeking to address the newly emerging needs of our society in light of Federal cutbacks. Yet, it is clear that most foundations use their resources to support traditional, established institutions rather than to provide venture capital for newly emerging concerns and developing community-based organizations.

Profile of Foundations

At the request of the Subcommittee, the General Accounting Office analyzed available IRS historical data on all types of private foundations as defined in Section 509 of the Internal Revenue Code. In general, GAO's analysis shows that private foundations have continued to increase in numbers and financial strength since 1969. The rate of their growth in numbers, however, has been substantially less than the rate for the 10-year period preceding the Act. On the other hand, their financial growth, as measured by the percentage of increase in the dollar value of contributions received by foundations, has exceeded the percentage of growth in the U.S. economy as measured by the Gross National Product.

More specifically, GAO's statistical analysis indicates that the number of private foundations have increased from 14,865 in 1962 to 31,866 in 1981—a 114 percent growth. Their assets at market value have increased, over the same period, from about $16.3 billion to about $51 billion—a 213 percent increase. Their total annual receipts also increased from about $1.9 billion to about $9.1 billion—a 379 percent increase. Concurrently, the total annual expenses of foundations increased from about $2.7 billion in 1974, the earliest year for which data was available, to about $4.8 billion in 1981—a 78 percent increase. Likewise, those expenses related to exempt purposes increased from about $1 billion in 1962 to about $3.2 billion in 1979, the most recent year for which data was available—a 220 percent increase. (See Appendix E, Tables 1 and 2.)

Notwithstanding these increases, the data also indicates that foundations, on a percentage basis, are spending less of each year's receipts. For example, in 1974 foundations spent about 97 percent of their total receipts, as compared to about 53 percent in 1981. Similarly, the percentage of total receipts spent for exempt purposes has also decreased—from about eighty-six percent in 1974 to about fifty-four percent in 1979.

To carry out their charitable activities, private foundations need to have a sound financial resource base. These resources have traditionally come from donations received by the foundations, as well as earnings on investments.

As previously discussed, the market value of foundation assets, expressed in actual dollars, increased substantially over the period 1962 through 1981. When expressed in constant dollars, however, the percentage of growth is not as substantial. In fact, over the last few years, asset values declined slightly. Even so, GAO's analysis of available data shows that private foundations have earned or received sizable revenues and have in recent years retained an increasing part of these revenues.

Investments make up a large and important part of private foundations' financial resources. In fact, the GAO analysis shows that foundations have extensive holdings in the stock of for-profit businesses. The depressed stock market conditions that existed until recently may help explain the declining trend in the real value of foundations' assets over the last few years.

Earnings on assets, particularly as measured by adjusted net income, are also important to the financial well-being of foundations and their ability to continually fund charitable activities. In this regard, GAO analysis of return data for 1979 shows that foundation adjusted net income, expressed as a percentage of foundation assets, was generally below 1979 inflation rates, which ranged between 8 and 13 percent depending on the measure used. This situation may help explain why private foundation disbursements for charitable purposes—expressed in constant dollars—did not increase significantly over 1974 levels. In general, foundations which had a more balanced mix of investments in corporate stocks and bonds and in cash investments and U.S. Government obligations had higher rates of return than foundations which had more concentrated corporate investments or other investments. Also, larger foundations generally earned a slightly higher rate of return than smaller foundations.

As previously discussed, private foundation financial growth appears substantial when measured in actual dollars. However, an examination of the financial data in terms of constant dollars shows a less dramatic picture. To obtain estimates in terms of constant dollars, GAO applied the Gross National Product Implicit Price Deflator to the current dollar data. Based on these estimates, foundation assets, at fair market value, increased from about $23 billion to $26.1 billion over the 19-year period—a thirteen percent increase. Over the last two years, however, these assets have shown about a five percent decline. Similarly, for the period 1962 to 1979, foundation disbursements for exempt purposes, in constant dollars, increased from about $1.4 billion to about $2.0 billion—a forty-three percent increase. However, since 1974, these disbursements also showed a five percent decline. On an annualized basis this represents about a .7 percent compounded growth rate for assets over the 19-year period and about a 1.9 percent compounded growth rate for charitable disbursements over the 17-year period.

Testimony by the Internal Revenue Service during the Subcommittee hearings supports the foundation profile developed by GAO.

IRS's Exempt Organization Master File records indicate an increase of approximately 10,000 private foundations over the last 10 years from 23,172 at the end of calendar year 1972 to 33,308 at the end of calendar year 1982. (See Tables 3 and 4 in Appendix E.) However, until approximately 1975, when there were 28,407 private foundations, the increase was mostly attributable to the classification of organizations whose determination of foundation status was suspended pending adoption of the final foundation classification regulations.

The fair market value of assets as reported on annual information return/report Form 990-PF increased from $35.3 billion for return year 1976 to $50.9 billion for return year 1981. The data from returns for years prior to 1976 is not as reliable as that for 1976 and subsequent years because of master file programming changes, changes in return processing procedures, and for years before 1974, the absence of final private foundation classification regulations.

Revenues of private foundations increased from $4 billion for return year 1976 to $9 billion for return year 1981. Total expenses increased from $2.8 billion for return year 1976 to $4.8 billion for return year 1981. Contributions, gifts, and grants paid out increased from $1.9 billion for return year 1976 to $3.6 billion for return year 1981.

In addition to information developed by GAO and IRS, the Foundation Center[1] has developed extensive information on foundations. Based upon detailed information gathered by the Center, there were 22,535 active grantmaking foundations in the United States during the 1979-80 fiscal year, which had combined assets of $41.6 billion and awarded grants totaling over $2.8 billion. Educational institutions, particularly private universities and colleges, received the largest of grants and grant dollars. Grants to direct service agencies follow a distant second. (More detailed information is provided in Appendix E. See Tables 5-14.) In addition, a greater emphasis on international grant-making seems to be emerging.

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[1] Since its establishment 26 years ago, The Foundation Center has served as the primary source of public information about private foundations.

VIII. RECOMMENDATIONS

1. Charitable Deduction Rules (IRC Sec. 170)

As outlined earlier, IRC sec. 170 provides for a deduction for charitable contributions. The amount of a donor's deduction may not exceed specified percentages of the donor's adjusted gross income. Under present law, there is a tax preference for contributions to public charities (and operating foundations). (See Part VI, supra.)

A. Five-Year Carryover (Sec. 170(d)(1))

Recommendation

The five-year carryover of excess contributions by individuals permitted under current law should be extended to contributions made to private nonoperating foundations.

Explanation

Under present law, contributions to public charities and private operating foundations in excess of the 50-percent limitation may be carried over to and deducted, subject to the 50-percent limit, in each of the donor's 5 taxable years following the year of the contribution. No such carryover is provided for contributions to private nonoperating foundations in excess of the applicable 20-percent limitation.

The Subcommittee, however, has found that the denial of a carryover of excess contributions to private nonoperating foundations does not gener[illegible]e to direct gifts to public charities, but merely serves to forc[illegible]fts to nonoperating foundations to be made in smaller [illegible] over several years, rather than one larger amount in one year. Therefore, the Subcommittee recommends extension of the 5-year carryover rule to contributions to private nonoperating foundations. The Subcommittee believes this extension would not be inconsistent with longstanding Federal tax policy which encourages contributions to public charities.

B. Percentage Limitations (Sec. 170(b)(1))

Recommendation

Current policy affording preferential tax treatment for contributions other than capital gain property to public charities should be retained.

Explanation

Contributions to private nonoperating foundations are generally deductible, for income tax purposes, only to the extent of 20 percent of the donor's adjusted gross income. In contrast, contributions (other than capital gains property) of cash or ordinary income property to public charities and operating foundations may be deducted to the extent of 50 percent of the donor's adjusted gross income. The Congress first distinguished between contributions to public charities and contributions to private foundations when the deductible limitation was increased for contributions to churches, schools, or hospitals in the Internal Revenue Code of 1954. While limitations on charitable contribution deductions have been raised on several occasions since 1954, the preferential tax treatment accorded contributions to public charities has been retained to encourage immediately spendable receipts for charitable purposes. Because public charities generally rely on public support and individual contributions and generally directly perform charitable services, the Subcommittee believes that the tax preference for contributions to public charities continues to be appropriate. While the Subcommittee acknowledges the substantial role of foundations in private philanthropy, it notes that there may be delays (in some instances, for extended periods) in redistributions by foundations of contributed funds to operating charitable organizations or programs.

C. Contributions of Appreciated Property (Sec. 170(e))

Recommendation

The current preferential tax treatment of gifts of appreciated property to public charities and operating foundations should be retained.

Explanation

Under present law, preferential tax treatment is accorded gifts of appreciated property (capital-gain property) to public charities and operating foundations. Donors of capital-gain property to public charities may deduct the full fair market value of the property. In contrast, the amount deductible for gifts of capital-gain property to grantmaking foundation equals the assets fair market value reduced by 40 percent of the unrealized appreciation (i.e., the amount by which the value exceeds the donor's basis in the property).

The distinction in the tax treatment of gifts of appreciated property under present law is based on the differences in character and operation of public charities and private grantmaking foundations and current tax policy which favors gifts to those organizations which provide more immediate, rather than delayed, public benefit. The Subcommittee believes current policy continues to be valid.

Inasmuch as, deductibility of the full fair market value of gifts of appreciated property allows a donor to receive a tax deduction for amounts which never have been taken into income, Congress has limited this tax benefit only for such gifts to public charities. Thus, current law is designed in part to preclude situations under prior law where a taxpayer could realize a greater after-tax profit by making a gift of the property than by selling it, paying tax on the gain, and keeping the proceeds. In addition, present law limits possible abuse in the overvaluation of assets.

2. Definition of Private Foundation and Public Charities: The 10-Percent Public Support Test (IRC Secs. 509(a)(1) and 170(b)(1)(A)(vi))

Recommendation

Existing organizations which exhibit certain characteristics indicating substantial public involvement (such as museums, libraries, and orphanages) should be exempted from the section 4940 2 percent excise tax on private foundation net investment income. In addition, such organizations should be required to meet specific standards of public representation on their governing bodies.

Explanation

One way in which an organization can qualify as a public charity is to demonstrate that it is publicly supported (IRC secs. 509(a)(1) and 170(b)(1)(A)(iv)). Publicly supported organizations are treated as public charities rather than as private foundations because it is expected that they must be responsive to the public in order to continue receiving public support. An organization may be considered publicly supported if it normally receives a substantial part of its support from governmental units, the general public, or a combination of these sources, if it is organized and operated to attract new and additional public support on a continuous basis, and if all the pertinent facts and circumstances indicate that it is in the nature of a publicly supported organization (Treas. Reg. sec. 1.170A-9(e)(3)). By regulation, no organization receiving less than 10 percent of its support from governmental units, the general public, or a combination of those sources will be treated as normally receiving a substantial amount of governmental or public support (Treas. Reg. sec. 1.170A-9(e)(3)(i)).

A variety of organizations that have been publicly supported charities for a number of years may no longer be able to meet the public support requirement because they have built up large endowments producing substantial income. These organizations, however, argue that while they may not meet the public support test, they possess other characteristics which indicate substantial public involvement.

Many of the organizations which fail to meet the ten percent public support test may be reclassified as private operating foundations. A private operating foundation is defined generally as a foundation which expends directly for the active conduct of exempt activities at least 85 percent of the lesser of its adjusted net income or its minimum investment return (IRC sec. 4942(j)(3)). Private operating foundations are subject to most of the rules applicable to private foundations generally, including the prohibitions on self-dealing and jeopardizing investments, the 2 percent tax on investment income, and the taxable expenditure limitations. Further, because such organizations are not public charities, grantors must exercise expenditure responsibility with respect to grants made to them.

However, private operating foundations do have certain advantages under present law over nonoperating foundations. Contributions to operating foundations are deductible to the same extent as contributions to public charities, while contributions to nonoperating foundations (with certain exceptions) receive less favorable treatment. Foundation grants to operating foundations generally may be counted by the donor foundation as qualifying distributions in satisfaction of the section 4942 payout rules, while grants to nonoperating foundations do not so qualify (with certain exceptions). Operating foundations are not subject to the section 4942 payout rules (although they must meet certain expenditure requirements to be classified as operating), while all nonoperating foundations are required to satisfy the section 4942 payout rules.

Because the 2-percent excise tax and the expenditure responsibility rules were identified as the most burdensome characteristics of nonpublic charity status for these organization, the Subcommittee determined that those organizations which exhibit certain characteristics indicating substantial public involvement and which meet certain standards of public representation on their governing bodies should be exempted from the IRC section 4940 2-percent excise tax. Special relief from the expenditure responsibility rules was determined to be unnecessary, in light of the Subcommittee's recommendation on the expenditure responsibility rules generally (see recommendation 5).

3. Excise Tax on Net Investment Income (IRC Sec. 4940)

Recommendation

The present 2 percent excise tax on investment income should be reduced to 1 percent, provided that the foundation's payout to charity is increased by an equivalent amount.

Explanation

The Tax Reform Act of 1969 imposed a 4 percent excise tax on the net investment income of private foundations (IRC sec. 4940). The section 4940 excise tax on investment income was imposed so that foundations would share some of the costs of government, particularly the costs of administering the tax laws relating to exempt organizations. The tax was reduced by the Revenue Act of 1978 to 2 percent, because the prior rate had produced more than twice the revenue needed to finance administration of the exempt organization provisions of the Code.

Amounts collected under the provisions of section 4940 during fiscal year 1982 totalled approximately $93 million. The Internal Revenue Service estimates that the total costs of administering the combined employee plans and exempt organizations programs in fiscal year 1982 were approximately $84.5 million, of which $51.1 million was for employee plans and about $33.4 million for exempt organizations.

Thus, section 4940 excise tax collections continue to exceed the costs of administering not only the exempt organizations program, but also the employee plans and exempt organizations program combined. Moreover, the amounts raised by this excise tax are not earmarked for the administration of employee plans and exempt organizations programs. Rather, they go into general revenues. The amount of funds available to the Internal Revenue Service generally continues to depend on the annual Treasury appropriations.

The Treasury Department testified that it was difficult to justify imposing a tax on private foundations alone among exempt organizations to finance supervision of all exempt organizations. Moreover, the foundation community argued that the tax reduces the amount of money that could otherwise be used for charitable purposes.

Although some concern was expressed over reducing any amount of revenues in the face of the large deficits anticipated over the next few years, the Subcommittee believes that the greater flow of money to charity that will occur if the reduction in the excise tax is conditioned on an equivalent increase in payout justifies the relatively minor revenue loss.

4. Mandatory Payout Rules (IRC Sec. 4942)

Recommendation

The amount of administrative expenses which can be counted as qualifying distributions, for purposes of meeting the minimum payout requirement, should be limited.

Explanation

Under present law, a private nonoperating foundation must make qualifying distributions, by the end of the following year, at least equal to 5 percent of its investment assets for the year (less the amount of section 4940 tax on the foundation's net investment income for the year).

Current law permits reasonable and necessary administrative expenses, including trustee compensation, which a foundation incurs in implementing its charitable purposes to count as qualifying distributions for purposes of meeting the minimum payout requirement. Accordingly, compensation, salaries, wages and other expenses paid in furtherance of the foundation's charitable purposes are, subject to a reasonable and necessary limitation, qualifying distributions.

The payout rules of the Tax Reform Act of 1969 replaced the prior-law prohibition on unreasonable accumulations of income which had proved to be insufficient to prevent foundations from delaying benefits to charity (the basis upon which favorable tax treatment is granted), by holding or investing in assets which produce little or no income (such as vacant land) and from failing to make distributions until the accumulation had become unreasonable. Prior to the 1969 Act, it was possible for a donor to the foundation to receive an immediate charitable deduction on the making of the gift to the foundation while there would be an indefinite delay until the benefit accrued to the public. Since donors to a foundation receive current tax benefits from their contributions, and since the foundation is exempt from tax on its earnings, the Congress enacted the payout rules to insure that the public receives a corresponding current benefit.

Further, certain of the tax rules governing foundations prohibit administrative expenses, including trustee compensation, that are unreasonable or excessive. Section 4941 permits reasonable compensation to be paid trustees and other foundation managers, but treats as prohibited self-dealing any payment of excessive compensation, thereby triggering an excise tax payable by the manager. Excessive compensation payments or other administrative expenses are also taxable expenditures and subject to the excise tax under Section 4945, since they do not further any exempt purpose of the foundation. Case law as well as Internal Revenue Service regulations provide guidelines to determine on a case-by-case basis whether compensation and other expenses are reasonable and necessary for accomplishing a foundation's exempt purposes.

However, the degree to which administative expenses may also be counted as a qualifying distribution affects the payout for the public benefit by reducing the actual amount of funds which reach charitable beneficiaries. At the request of the Subcommittee, the General Accounting Office (GAO) surveyed private foundations' information returns for tax year 1979. The results of the GAO survey suggest that foundations count over 90 percent of all administrative expenses as being for exempt purposes, and that the portion of administrative expenses other than grantmaking expenses foundations allocate as qualifying distributions range from 10 to 17 percent.

Although current law contains prohibitions against excessive compensation and unreasonable administrative expenses, the Subcommittee is concerned whether IRS has sufficient resources to monitor adequately and enforce these requirements. A statutory percentage limitation on the amount of administrative expenses which can be counted toward the minimum payout requirement would ensure that more foundation dollars actually reach charitable beneficiaries and would be an objective and effective enforcement mechanism.

5. Expenditure Responsibility Rules (IRC Sec. 4945)

Recommendation

The Department of the Treasury should review (1) its regulations with regard to reports by grantor foundations to the Internal Revenue Service and (2) its regulations concerning other expenditure responsibility requirements, with a view to modifying any aspects of the rules found to be unduly burdensome or unnecessary.

Explanation

Private foundations making grants to organizations other than public charities are required to take certain steps to insure that such grants will be properly used by the recipient for charitable purposes. The grantor must make reasonable efforts and establish adequate procedures for the following purposes: (1) to see that the grant is spent solely for proper uses, (2) to obtain full reports from the grantee, and (3) to make full reports to the Internal Revenue Service on the grants (IRC sec. 4945).

Treasury regulations provide specific guidelines for complying with the expenditure responsibility rules. However, the regulations specifically state that the expenditure responsibility rules do not make donor foundations guarantors of the activities of the donee organizations.

The Subcommittee is not convinced that the general requirements for expenditure responsibility impose such a substantial administrative burden on grantor foundations to justify any kind of *de minimis* exception to those rules. The Subcommittee believes that the original purpose of the rules, that foundations should be responsible for their grantmaking activities, is still valid.

To the extent that the implementation of the statutory requirements in Treasury regulations may have added unduly burdensome or unnecessary requirements, the Subcommittee is concerned that those rules may be deterring grants to newly formed, community-based organizations. Therefore, under the Subcommittee recommendation, the Department of the Treasury is to review its regulations to determine whether modifications are appropriate to alleviate the administrative burdens without lessening the responsibility that a foundation should take for its grantmaking. The Subcommittee further recommends that the Treasury Department report to the Committee on Ways and Means on actions it has taken regarding this matter.

6. Reliance on IRS Determination of Grantee Status (IRC Sec. 4945)

Recommendation

The Treasury Department should modify its regulations to extend the 2-year advance ruling period during which new organizations can be considered "public charities." Other present law rules concerning formal IRS determinations should be retained.

Explanation

Private foundations must exercise expenditure responsibility with respect to grants made to another private foundation. In addition, distributions to a private nonoperating foundation may not be used to satisfy the foundation's minimum distribution requirements unless the amount of the contribution is distributed by the donee foundation for charitable purposes within one year after the year of receipt. Therefore, in order to avoid violations of the expenditure responsibility rules and the minimum distribution rules, a private foundation must determine whether a potential donee is a private foundation or public charity.

In many cases the public charity status of a donee is determined by the percentage of its support that is received from the general public. The Internal Revenue Service issues determination letters to all charities relating to their status as public charities. For new organizations without four years of support history, advance rulings are issued based on a determination that the charity can reasonably be expected to meet the public support test during an advance ruling period of either two or five years. In general, a donor is permitted to rely on an IRS determination of a donee's public charity status until publication of notice of a change of status. However, reliance is not permitted where the donor has knowledge that the IRS has given the donee notice that its status would be changed or where the donor is responsible for or aware of a substantial and material change in the donee's support which causes the donee to lose its public charity status.

To facilitate reliance on published classifications, the IRS issued guidelines in 1981 specifying circumstances under which a donor foundation will not be considered responsible for a "substantial and material" change in support of the donee organization. If the aggregate of grants from the donor organization for a year does not exceed 25 percent of the aggregate support received by the donee organization from all other sources for the four taxable years immediately preceding the year of the grant, then the donor foundation can rely on the classification of the donee organization as publicly supported without risk that its grant will later be treated as causing the donee organization to lose its public charity status thereby subjecting the donor foundation to excise tax penalties for failure to exercise expenditure responsibility. The IRS also published guidelines in 1981 specifying circumstances under which a grant will be considered "unusual" and hence will not cause the donee organization to lose its status as publicly supported.

While the Subcommittee believes that it is appropriate for foundations to inquire whether its grant would cause the donee to lose its public charity status, the Subcommittee is concerned that private foundations may hesitate to make grants to new organizations that are most in need of support but which have little support from the general public in the first two or three years of existence, because it is difficult for the foundation to obtain assurance that the grant will not cause the organization to fail to qualify for public charity status. Therefore, the Subcommittee recommends that the Treasury extend the 2-year advance ruling period during which new organizations can be considered "public charities," so that new organizations will have a better opportunity to attract the public support necessary to qualify as a public charity. In addition, the Subcommittee recommends that the Department of the Treasury review its guidelines concerning the circumstances under which a donor foundation will not be considered responsible for a "substantial and material" change in support of the donee organization, to determine whether further reliance on published classifications can be facilitated.

7. Voter Registration (IRC Sec. 4945)

Recommendation

The Subcommittee recommends that present law should be retained except for the requirement that grantees' voter registration activities must be carried out in at least five or more States.

Explanation

Under present law, an excise tax is imposed on private foundation expenditures for nonexempt purposes, including expenditures for political activities. Expenditures paid or incurred by a private foundation to influence the outcome of any specific election or to carry on, directly or indirectly, voter registration activities are taxable expenditures (section 4945(d)(2)). However, current law provides an exception for amounts paid to, or incurred by, certain organizations that are engaged in nonpartisan voter registration activities if the following requirements are met (section 4945(f)):

(1) The organization must be described in section 501(c)(3) and exempt from tax under section 501(a);

(2) The voter registration activities must be nonpartisan, not confined to one specific election period, and must be carried on in no less than five States;

(3) The organization must spend at least 85 percent of its income directly for the active conduct of activities constituting the purpose for which it is organized and operated;

(4) The organization must also receive at least 85 percent of its total support (other than gross investment income) from other exempt organizations, the general public, governmental units, or any combination of these sources. However, the organization may not receive more than 25 percent of such support from a single exempt organization, nor may it receive more than 50 percent of its support from investment income; and

(5) Contributions to the organization for voter registration activities must not be subject to conditions that they be used only in specified States, or political subdivisions, or that they may be used only in one specified election period.

Present law is designed to address the goal of encouraging private foundation support for certain nonpartisan voter registration activities. At the same time, present law seeks to deter private foundations from engaging in narrowly limited activities which are intended to favor particular candidates and which are partisan in nature. Elimination of the "five State rule," while retaining all other requirements under current law, is consistent with these objectives. In addition, the Subcommittee notes that donee organizations which can engage in voter registration activities must be tax-exempt under section 501(c)(3). As such they are prohibited from engaging in partisan activities.

8. Definition of Disqualified Person: Members of the Family (IRC Sec. 4946)

Recommendation

Lineal descendants of a disqualified person who are considered members of the family, and as such, disqualified persons, should be limited to the individual's children, grandchildren, and great-grandchildren and the spouses of such descendants.

Explanation

Under present law, the tax rules applicable to private foundations in effect prohibit certain transactions or holdings involving a "disqualified person" and a private foundation. The term "disqualified person", as defined in section 4946, includes substantial contributors to a foundation, foundation officers, directors, or trustees, and members of the family of such an individual, plus certain other related entities. The disqualified family members are the individual's spouse, ancestors, and all lineal descendants (and their spouses). The term "substantial contributor" means a person whose contributions to the foundation exceeded 2 percent of all contributions received by the foundation before the close of the year in which the contribution is made, but only if the person's contributions exceed $5,000. Once a person becomes a substantial contributor, that person remains a substantial contributor and hence, along with family members, a disqualified person with regard to that foundation, for all time.

At some point the connection between the foundation and a lineal descendant of a disqualified person becomes sufficiently remote and unrelated to the foundation that it is no longer necessary to treat the descendant as a disqualified person. The administrative burden and expense of keeping track in perpetuity of all lineal descendants of a substantial contributor must be weighed against the benefits to be obtained from application of the private foundation rules to distant relatives.

The Subcommittee has concluded that it is appropriate to include only children, grandchildren, and great-grandchildren (and their spouses) in lineal descendants who are disqualified persons by reason of being members of a disqualified person's family. Such a limitation would ease substantially the administrative burdens now imposed on foundations, while preserving the essential integrity of the private foundation rules and restrictions themselves.

9. First-Tier Penalty Taxes (IRC Secs. 4941–4945)

Recommendation

The Internal Revenue Service should be granted discretionary authority to abate first-tier penalty taxes, except those imposed for acts of self-dealing, if the foundation establishes reasonable cause and demonstrates that there has been no willful disregard of the law.

Explanation

The Tax Reform Act of 1969 established a two-tiered system of excise taxes intended to ensure compliance with the private foundation rules set forth in IRC sections 4941–4945.

Any violation of the foundation rules results in imposition of an initial—first-tier—excise tax on the foundation (or in the case of self-dealing, on the disqualified person who entered into the prohibited transaction with the foundation). If a violation of the foundation rules is not collected within a specified period, an additional—second-tier—excise tax is imposed.

In general, the first-tier excise tax on the foundation (or on the disqualified person engaged in self-dealing) applies automatically when a foundation rule is violated, even if the violation in a particular instance could be deemed inadvertent. However, where a foundation fails to satisfy the section 4942 payout requirements solely as a result of an incorrect asset valuation which was due to reasonable cause, the excise tax under that section is excused if the payout deficiency is made up during a specified period.

If there is a violation of the prohibitions on jeopardizing investments, taxable expenditures, or self-dealing, an initial excise tax is imposed on any foundation officer, director, trustee, or responsible employee who knowingly participated in the prohibited act, unless the manager had reasonable cause to excuse participation in the act.

The 1969 rules governing private foundations were designed to provide clear standards for determining when a violation occurs and to impose automatically a penalty on any violation. The knowledge that the penalty for a violation must be paid in all events was intended to encourage foundation managers to familiarize themselves with the rules and exercise care to avoid violations.

Clearly, ignorance of the law is no excuse for wrongful acts. However, present law automatic penalties are stricter than necessary to enforce the foundation requirements in certain circumstances. Therefore, in those instances where it can be shown that there was reasonable cause for the violation (other than self-dealing) and there was no willful disregard for the rules, the Internal Revenue Service should be permitted to relieve the foundation from the automatic penalty rule. The Subcommittee finds no justification for extending such an abatement mechanism to acts of self-dealing, particularly since the penalty tax for such violations is payable by the self-dealer, not by the foundation, and since under current law commercial transactions between disqualified persons and foundations are generally prohibited.

10. Public Disclosure and Accessibility of Information on Foundations to Grant Applicants (IRC Sec. 6104)

Recommendation

The IRS should fully enforce present law requirements concerning private foundation Form 990-PF information returns. In addition, private foundation notices which are currently required to be published annually in a newspaper should include a telephone number for the foundation.

Explanation

In reviewing prior-law annual filing and disclosure requirements during consideration of the 1969 Tax Reform Act, the Congress concluded that additional information was needed on a more current basis from all types of exempt organizations, and that this information should be made available more readily to the public, including State officials. (Under State law, the attorney general may have certain supervisory and enforcement powers over foundations and other charitable organizations.) Consequently, the 1969 Act applied expanded reporting requirements to all exempt organizations and, particularly, to private foundations.

A private foundation must file with the IRS an annual information return/report (Form 990-PF), and must furnish a copy to the attorney general (or other official) in the relevant State. The return must include information concerning receipts and expenditures, book and market value of assets, foundation managers (names, addresses, and compensation), substantial contributors, and grants made by the foundation (including the names and addresses of grantees, and grant amounts and purposes).

In addition, the 1982 return calls for certain information regarding applications for grants from the foundation, including (1) the name, address, and telephone number of the person to whom applications should be addressed; (2) any required format, information, and materials; (3) deadlines for submitting applications; and (4) any limitations on the types of awards which the foundation makes, such as by geographical areas, charitable fields, kinds of donee institutions, etc.

For 1982 and later years, the annual return filed by private foundations with the IRS, and made available to the public, contains information of use to grant applicants, as well as information concerning foundation activities, expenditures, and compliance with the foundation rules. However, the GAO, based on a study of pre-1982 returns, concluded generally that foundations often fail to complete fully the parts of the return relating to such types of information, and that the IRS has not been fully attentive to enforcing the return requirements as to such information.

The General Accounting Office has conducted a study of enforcement by the IRS of the reporting requirements for private foundations, by reviewing more than 1500 returns filed primarily for tax years 1976–1981. GAO concluded that private foundations generally comply with the reporting requirements which the IRS requires for tax administration. However, the study found that the IRS devoted little attention to the reporting requirements which provide information that primarily is useful to the public and to the Congress for monitoring foundation activities. Accordingly, GAO stated, foundations often fail to submit this information.

Because the private foundation reporting requirements provide valuable information both for public information purposes and for tax administration purposes, the Subcommittee recommends that the IRS make changes in its enforcement activities to ensure availability of this information. In addition, the Subcommittee recommends that in appropriate cases the IRS should assess the penalties for failure to file a (complete) return when a foundation does not provide all required information.

It was noted at the Subcommittee hearings that some foundations may not make their telephone numbers readily available to the public. The annual return form requires foundations to provide the telephone numbers of the person to whom grant applications should be submitted and the person who has possession of the foundation's books. The Subcommittee recommends modifying the present-law requirement concerning newspaper publication as to availability of the foundation's principal office and the name of its principal manager, to require listing the telephone number for the foundation's principal office or for the person to whom grant applications should be submitted.

While the Subcommittee acknowledges the resources presently available to grantseekers, it is concerned that the general public may still experience difficulty in obtaining adequate information about foundation grantmaking. Therefore, the Subcommittee urges private foundations to voluntarily provide the public with information in a more accessible and understandable format than the annual information return/report Form 990-PF. The Subcommittee also encourages private foundations to publish annual reports and engage in public outreach activities.

11. Excess Business Holdings (IRC Sec. 4943)

A. Post-1969 Gifts and Bequests

Recommendation

With regard to post-1969 holdings acquired by gift or bequest, the Subcommittee recommends granting IRS discretionary authority to permit additional time to divest such excess holding upon a showing by the foundation of good cause and good faith efforts to dispose of the excess holding within the time limits under present law.

Explanation

Under present law, the combined ownership of a business by a private foundation and all related persons cannot exceed 20 percent of the stock of the business. If after 1969 a foundation receives excess business holdings by gift or bequest, the foundation generally has five years in which to reduce its holdings to the permitted levels.

The Subcommittee believes in certain limited circumstance the 5-year disposition period under present law may be insufficient for orderly divestiture. For example, disposition of unusually large business holdings, and holdings which are inordinately complex, may require a longer divestiture period.

The Subcommittee believes granting the IRS discretionary authority to grant an additional 5 years to divest (as opposed to the enactment of a blanket statutory extension) is appropriate to handle such situations. Discretionary authority that may be applied only upon the satisfaction of narrowly defined criteria would be consistent with the policies of present law. Accordingly, exercise of such discretionary authority would only be considered in cases where a foundation showed unique facts concerning the largeness or complexity of its holding, its good faith and diligent efforts to dispose of the holding within the present divestiture period, its willingness to dispose of the excess holding and realistic plans to do so within the extension period.

B. Grandfathered Holdings

Recommendation

With regard to pre-1969 holdings, the Subcommittee makes no recommendations concerning specific foundations seeking exemptions from present law. However, the Subcommittee recommends that the Committee on Ways and Means consider the following options in evaluating this matter:

Option No. 1—Retention of present law.

Option No. 2—Exemption from present law divestiture rules if: (i) less than a majority of the governing body of the foundation (i.e., board of directors or trustees) consists of officers or employees of the business enterprise classified as the "excess business holding"; and (ii) the foundation meets the minimum payout requirements of present law. In addition, non-voting preferred stock would not be counted in determining whether there is an excess business holding by a private foundation.

Option No. 3—Exemption from present law divestiture rules if: (i) the business enterprise and the private foundation do not have interlocking or related governing bodies, officers, or employees; (ii) the annual minimum cash return on the excess business holding is no less than 7.5 percent; (iii) the foundation's annual payout for charitable purposes is an amount no less than 7.5 percent of the value of foundation's investment assets ; and (iv) there is no increase in the excess business holdings of the foundation.

Explanation

Present law generally limits the combined ownership of a business corporation and disqualified persons to not more than 20 percent of the stock. Special rules are applicable to business holdings of a foundation which exceeded the 20 percent limitation on May 26, 1969 (so called "grandfathered holdings"). In general, grandfathered holdings are permitted to be retained under special rules requiring gradual reduction in the amount of the holding. (See Part IV–D, supra.)

The excess business holdings rules of present law were enacted in light of findings that prior law had been inadequate to prevent the use of foundations to control business enterprises for private purposes at the expense of charity. The lengthy hearings held by the tax-writing committees prior to the Tax Reform Act of 1969 and the 1965 Treasury report on private foundations demonstrated specific instances of such abuse.

Option 1 described above would retain the excess business holdings rules of present law. Underlying this option is the view that only present law adequately addresses prior abuses and in concert with other rules ensures that foundation assets will be devoted to charitable, rather than private purposes. For example, present law promotes the security of foundation assets and future income by encouraging diversity of foundation investments and protects against substantial holdings in unproductive assets. Present law also encourages foundation managers to devote attention to charitable purposes as opposed to the active conduct of businesses.

Option 1 also reflects a view that the transition periods provided for initial dispositions (10, 15 or 20 years depending on the level of foundation holdings) have been sufficient for compliance by the majority of foundations. Under this view, an exemption would be unfair to those foundations that were similarly situated but divested themselves of excess business holdings in compliance with the law.

Options 2 and 3 would exempt from the divestiture rules of present law grandfathered holdings under certain circumstances.

In evaluating the provision of specific rules such as those contained in Options 2 and 3, the Committee should consider whether there may be abuses that are addressed by the general prohibition against excess business holdings but for which specific rules could not be provided. In addition, there may be problems for which specific rules do not work well. For example, it may be difficult to develop specific rules to prohibit the diversion of management attention from the charitable activities of the foundation to the business activities of the corporation. Similarly, the valuation of interests in closely held businesses is very difficult. Uncertainties in valuation makes the minimum investment return (for section 4942 purposes) very difficult to enforce.

Underlying Options 2 and 3 is the view that in certain instances the advantages of foundation ownership of a business may outweigh its disadvantages. For example, divestiture may not be desirable where a foundation-owned stock in a single business entity in fact performs exceptionally well compared to composites. In addition, these options reflect a view that other public policies may favor continued foundation ownership of a business enterprise. Thus, the enactment of special rules would permit a foundation to retain grandfathered holdings and, acting in concert with other existing rules, also prevent the specific abuses that present law is designed to address.

Options 2 and 3 would exempt grandfathered holdings from the divestiture rules of present law provided that the foundation meet certain additional requirements. In general, these requirements involve the composition of the governing bodies of the foundation and the business enterprise and the amount of the foundation's charitable distributions.

Both Options 2 and 3 contain requirements concerning the composition of the governing bodies of the foundation and the business enterprise and other employees. Option 2 would permit one-half of the members of the governing body of the foundation to consist of officers and/or employees of the business enterprise classified as an excess business holding. Option 3, in general would not permit dual service.

Options 2 and 3 each contain requirements regarding a foundation's annual charitable distributions. Under Option 2, a foundation would be required to meet the minimum payout under present law (5 percent of the fair market value of all of its investment assets). Under Option 3, to retain excess holdings, a foundation would be required to make increased charitable distributions. A foundation would be required to pay out no less than 7.5 percent of the value of all of its investment assets (an increase of 2.5 percent over the present-law minimum). In addition, Option 3 would require that the cash return on the foundation's excess holding be no less than 7.5 percent, and would prohibit the foundation from increasing its excess holdings.

Under Option 2, nonvoting preferred stock would not be counted in determining whether there is an excess holding by a private foundation. Option 3 contains no similar provision.

C. 20-Year Disposition Rule

Recommendation

With regard to the "grandfather rules" relating to pre-1969 holdings, the Subcommittee recommends that a foundation should be eligible for the 20-year rule where the combined holdings of the foundation and disqualified persons were greater than 95 percent on May 26, 1969.

Explanation

Present law generally limits the combined ownership of a business enterprise and disqualified persons to not more than 20 percent of the stock. Special rules are applicable to business holdings of a foundation which exceeded the 20 percent limitation on May 26, 1969 (so-called "grandfathered holdings"). In general, grandfathered holdings are permitted to be retained, but under these special rules are subject to gradual reduction over 10, 15, or 20 years depending on the level of holdings.

The criteria for determining the applicable reduction period are not uniform. The determination whether the reduction period is 10 or 15 years is based on the level of combined holdings by the foundation and foundation/disqualified person holdings. However, the determination whether the foundation's reduction period is 20 years is based solely on the level of foundation holdings (i.e., the holdings of disqualified persons is not taken into account).

The Subcommittee believes uniform criteria for the determination of the applicable reduction period are appropriate and is consistent with the basic policy of phased divestiture of pre-1969 holdings.

D. "Downward Ratchet" Rule

Recommendation

With regard to the "downward ratchet" rule, the Subcommittee recommends that a foundation not be required to decrease its holdings on account of a change in the foundation/disqualified person percentage holdings which is attributable to stock issuances or redemptions (or issuances coupled with redemptions) under certain circumstances.

Explanation

Present law generally limits the combined ownership of a business corporation by a private foundation and disqualified persons to not more than 20 percent of the stock. Increases in holdings above the permitted level may result in excise tax penalties on the foundation, subject to a 90-day grace period for a foundation to reduce its holdings as required after purchases by a disqualified person.

Under the "downward ratchet" rule (part of the excess business holdings provisions of the Code), if a private foundation must reduce its holdings because of stock purchases by disqualified persons which make the combined holdings exceed the applicable percentage limitation, the foundation cannot thereafter acquire more stock to restore its holdings to the former level (unless the combined holdings after such acquisition by the foundation do not exceed 20 percent). The purpose of the rule is to prevent the foundation from purchasing additional holdings in the business enterprise until the substituted combined foundation/disqualified person holdings are reduced to the permitted levels.

The Subcommittee is concerned that under certain circumstances involving an increase in foundation holdings due to a stock issuance or redemption, the operation of the downward ratchet rule may cause undue hardship. A modification of the rule in such cases would not be inconsistent with the basic purpose of the rule to limit foundation ownership of business enterprise.

E. Second Divestiture Phase

Recommendation

The Subcommittee recommends that consideration be given to simplification of the second divestiture phase.

Explanation

As discussed in item B above, grandfathered holdings are subject to gradual reduction (see also Part V, item D). After expiration of the first phase, a second set of divestiture requirements becomes operational. If disqualified persons do not own more than two percent of the corporate voting stock at any time during the 15 years after the close of the first phase, the combined foundation/disqualified person holdings must be reduced to not more than 35 percent by the end of that period (i.e., for a foundation which itself owned 95 percent of the stock on May 26, 1969, by May 26, 2004); the foundation itself cannot hold more than 25 percent if disqualified person ownership exceeds two percent. If disqualified persons own more than two percent of the corporate voting stock at any time after the close of the first phase, the combined holdings may continue up to 50 percent without reduction, except that the voting stock held by the foundation must be reduced to 25 percent at such time beginning with the close of the first phase as disqualified person ownership exceeds two percent.

The Subcommittee believes that the second divestiture phase could be simplified without undermining the basic policies concerning foundation business holdings. Simplification would not be inconsistent with the policy of phased divestiture.

12. Definition of Disqualified Person: Substantial Contributor (IRC Secs. 4946 and 507(d)(2))

Recommendation

The definition of substantial contributor should be modified so that an individual may lose such status for certain purposes.

Explanation

Under section 4946, the term "substantial contributor" means any person whose contributions to the foundation (or organization, for section 509(a)(2) purposes) exceeded 2 percent of all contributions received by the foundation before the close of the year in which the contribution is made, but only if the person's contribution exceeded $5,000. In computing the $5,000/2-percent limit, all contributions and bequests to the foundation since its creation are taken into account. Status as a substantial contributor/disqualified person is permanent. Once substantial contributor status is acquired, that person remains a substantial contributor with respect to that foundation (or organization) for all subsequent time (even though he or she might not be so classified if the determination were made at some later date).

A person's status as a substantial contributor, and hence a disqualified person, is important for both foundations and certain public charities. Code sections 4941–4945 restrict transactions etc. between disqualified persons and foundations. Also, contributions to an organization from a disqualified person do not count as public support for purposes of satisfying the one-third public support test to qualify as a section 509(a)(2) public charity.

A foundation in effect must maintain records of all these persons as well as their holdings in any stock which may constitute excess business holdings of the foundation. The Subcommittee is concerned that this requirement may impose a difficult and costly burden upon a foundation after a number of years. Moreover, present law does not take into account the overall growth of support in future years which diminishes the significance of earlier contributions.

However, liberalization of the substantial contributor definition is not appropriate in all circumstances, for instance, in the case of the self-dealing rules. Therefore, the Subcommittee recommends that modification of the definition be limited only to certain circumstances, such as for purposes of computing excess business holdings.

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Additional Comment

As reflected in the foregoing recommendations, the Subcommittee adopted a generalized approach for evaluation of the rules governing private foundations and proposals for modification of those rules. The Subcommittee thus avoided any recommendation for change in the current restrictions that could be classified as foundation specific—that is, recommendations of special relief for a particular foundation.

Several members of the Subcommittee have expressed interest in one request for foundation-specific relief from present law self-dealing rules (presented at the hearings). While the Subcommittee has taken no position on this matter, it is presented below for the Committee's review.

A company-related foundation has requested an exception from self-dealing prohibitions in order to allow the foundation to exercise options to purchase company stock contributed to it by its creator company.[1] The company is a substantial contributor and hence a disqualified person by virtue of having made cash contributions of over $5,000 to the foundation which exceeds 2 percent of all contributions received by the foundation. The proposal seeks to amend the private foundation rules to permit, in certain limited cases, the exercise of an option to purchase stock from a substantial contributor to the foundation provided certain conditions are met that are designed to ensure against opportunities for abuse. The company suggests that under such carefully prescribed circumstances, the exercise of the option would always inure to the foundation's benefit.

Current law prohibits private foundations from engaging in transactions with related persons referred to as disqualified persons. (See Part V, G.) The prohibited self-dealing acts include generally the sale, exchange or leasing of property, loans, or furnishing of goods, services, or facilities, including transactions for adequate consideration or which may benefit the foundation.

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[1] The intended beneficiary of this proposal is the Hospital Corporation of America, Memphis, Tenn.

An excise tax is imposed on a disqualified person who is the self-dealer, for each act of self-dealing with a foundation. The tax is also imposed on a foundation manager, but not the foundation itself, who participates, knowing the act constitutes self-dealing.

APPENDIX A.—LETTER OF HEARING REQUEST

COMMITTEE ON WAYS AND MEANS,
U.S. HOUSE OF REPRESENTATIVES,
Washington, D.C., December 14, 1982.

Hon. CHARLES B. RANGEL,
Chairman, Subcommittee on Oversight, Committee on Ways and Means, Longworth House Office Building, Washington, D.C.

DEAR CHARLIE: As you know, the present rules governing the tax treatment of private foundations were enacted as part of the Tax Reform Act of 1969 (P.L. 91-172). With limited exceptions, there has been no comprehensive review of these provisions by the Committee on Ways and Means since their enactment in 1969. In addition, issues relating to the operation of these provisions have been raised, most recently in the conference on the Tax Equity and Fiscal Responsibility Act of 1982 (P.L. 97-248).

In light of this, I would request the Subcommittee on Oversight to conduct a detailed examination of the rules governing private foundations in the 98th Congress, and to report its findings and such recommendations, if any, as may be appropriate to the full Committee on Ways and Means.

With warm regards, I am,
Sincerely yours,

DAN ROSTENKOWSKI,
Chairman.

APPENDIX B.—SUBCOMMITTEE PRESS RELEASES ANNOUNCING PRIVATE FOUNDATION RULES HEARINGS

[For Immediate Release, Press Release No. 25, Dec. 20, 1982]

HON. CHARLES B. RANGEL (DEMOCRAT OF NEW YORK), CHAIRMAN, SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES HEARINGS ON PRIVATE FOUNDATIONS

The Honorable Charles B. Rangel (D., N.Y.), Chairman of the Subcommittee on Oversight of the Committee on Ways and Means, announced today that hearings to examine the rules governing private foundations will be held early in the 98th Congress. Further details and specific dates for the hearings will be announced later.

These hearings are being scheduled at the request of the Honorable Dan Rostenkowski (D., Ill.), Chairman of the Committee on Ways and Means. In 1969, Congress enacted a comprehensive set of rules regulating private foundations. With limited exceptions, there has been no comprehensive review of these rules since the enactment of the Tax Reform Act of 1969 (P.L. 91-172). In addition, issues relating to the operation of these foundation rules have been raised, most recently during the conference on the Tax Equity and Fiscal Responsibility Act of 1982 (P.L. 97-248).

The Subcommittee will examine the impact of the 1969 Act on the vitality of private foundations. The hearings will address present rules and regulations which may promote or impede the operations of private foundations. The Subcommittee will seek testimony from the Department of the Treasury on its experience with administering the statute, including identification of any specific problem areas. Private tax practitioners, legal scholars, private foundation managers and recipients of private foundation grants will also be invited to testify. Detailed information to develop a profile of the characteristics of private foundations and a survey of their experiences with the 1969 Act will be requested. This information will assist the Subcommittee in determining whether the current rules, without imposing unnecessary or unduly burdensome restrictions, ensure only those private foundations operating for the public benefit enjoy favorable tax treatment.

[For Immediate Release, Press Release No. 5, Tuesday, May 3, 1983]

HON. CHARLES B. RANGEL (DEMOCRAT OF NEW YORK), CHAIRMAN, SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS, ANNOUNCES FURTHER DETAILS ON HEARINGS ON PRIVATE FOUNDATIONS

The Honorable Charles B. Rangel (D., N.Y.), Chairman of the Subcommittee on Oversight of the Committee on Ways and Means, announced today that the Subcommittee will conduct hearings to examine the rules governing private foundations on Monday, June 27, and Tuesday, June 28, 1983.[1] The hearings will be held in Room 1100 Longworth House Office Building and will begin at 10:00 a.m. each day. These hearings were previously announced on December 20, 1982 (Press Release #25), and are being held at the request of the Honorable Dan Rostenkowski, Chairman of the Committee on Ways and Means. Information will be sought to assist the Subcommittee in determining whether the current rules first enacted in the Tax Reform Act of 1969 (P.L. 91-172), without imposing unnecessary or unduly burdensome restrictions, ensure that only those private foundations operating for the public benefit enjoy favorable tax treatment.

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[1] Press release No. 6, not printed here, added Thursday, June 30, 1983, as an additional day of hearings.

Framework for discussion

I. Foundation profile questions

The Subcommittee seeks information on the following general questions:

(A) What role do private foundations play in private philanthropy?

(B) How are private foundations responding to the President's call for increased voluntarism and private sector initiative in light of reduced Federal spending?

(C) What are the sources of funding for private foundations?

(D) What philanthropic activities are private foundations undertaking?

(E) Who are recipients of the charitable distributions of private foundations?

(F) What are private foundations' payout rates for qualifying charitable distributions?

(G) What types of assets do private foundations have, and what is the rate of return on each type of asset?

(H) What types of investments do private foundations engage in, and what investment policies guide their decision-making regarding investment selections?

(I) What portion of the qualifying distributions of private foundations represent administrative expenses, particularly trustee compensation?

(J) What has been the effect of the Tax Reform Act of 1969 on the operations, vitality and growth of private foundations?

(K) Is avoidance of private foundation status a factor that is considered in deciding upon the format for philanthropic activities? If so, why?

(L) What type of public disclosure and accountability are afforded by private foundations, and how helpful is it to potential grantees and to the public in general?

II. Issues relating to present statutory structure

In addition, the Subcommittee requests comments on the issues surrounding the rules and regulations governing private foundations including, but not limited, to the following:

A. Divestiture requirement for business holdings acquired by gift or bequest

1. What foundations have divestiture problems with regard to excess business holdings, and why?
2. Are there any circumstances under which relief from the divestiture rules would be appropriate?
3. If such circumstances do exist, what form of relief is warranted?

B. Definitions of disqualified persons

1. Are any statutory definitions of disqualified persons unnecessarily stringent or overboard?
2. If so, what definitions are they and how should they be limited?

C. Expenditure responsibility

1. To what degree are private foundations administratively burdened in exercising expenditure responsibility?
2. To what degree do the expenditure responsibility requirements influence foundations' grant-making decisions?
3. Should the expenditure responsibility requirements be eased, and if so, in what manner?

D. Penalty taxes

1. Are there circumstances in which the automatic imposition of the first-level penalty taxes is unwarranted?
2. Should the Secretary of the Treasury be authorized to abate the first-level penalties?
3. What type of abatement mechanism could be authorized which would in no way lessen compliance with the rules?

E. Two-percent excise tax

1. Is the collection of the 2 percent tax still in keeping with the purpose for which it was originally intended?
2. How are the revenues raised by this tax being used?
3. To what degree does the 2 percent tax erode the resources that are available for charitable purpose?

F. Declaratory judgment procedure

Is the availability of the declaratory judgment procedure too restrictive?

G. Administration of the statutory rules by the Internal Revenue Service

1. Is the "10-percent public support" test set forth in the regulations relating to the definition of private foundation too restrictive?

Should certain organizations which fail to meet the "10-percent" test nevertheless be excluded from private foundation status?

2. In what ways should the Form 990-PF, Return of Private Foundations, be improved?

3. Should the regulatory restrictions on reliance by a private foundation on an IRS ruling as to the public status of a potential grantee be modified? If so, how?

H. Compliance

1. To what extent are private foundations complying with the rules set forth in 1969?

2. Have the 1969 rules succeeded in eliminating the abuses the rules were intended to address?

3. Are there any ways in which the current rules can be so manipulated that an organization may avoid private foundation status and the restrictions that follow such status?

I. Simplification

How can existing law be simplified?

Details for submissions of requests to be heard

In addition to testimony received from invited witnesses, individuals and organizations interested in presenting oral testimony at the hearing should submit their requests to be heard by telephone to Harriett Lawler ((202) 225-3627) *no later than the close of business, Friday, June 10, 1983,* to be followed by a formal written request to John J. Salmon, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. Notification to those scheduled to appear will be made by telephone as soon as possible after the filing deadline.

It is urged that persons and organizations having a common position make every effort to designate one spokesperson to represent them in order for the Subcommittee to hear as many points of view as possible. Time for oral presentations will be limited with the understanding that a more detailed statement may be included in the printed record of the hearing. This procedure will afford more time for Members to question witnesses. In order to expedite the hearing, witnesses may be grouped in panels with time limitations for each panelist.

Requests to be heard must contain the following information:

(1) The name, address, title, firm affiliation and/or organization the witness will represent (as well as a telephone number where he or his designated representative may be reached);

(2) If appearing in an individual capacity, a list of any clients at whose request or in whose employ the witness appears; and

(3) A topical outline or summary of comments and recommendations.

The above information should also be incorporated in the prepared statements to be presented in person as well as those filed for the written record of the hearing.

In order to assure the most productive use of the limited amount of time available to question hearing witnesses, witnesses scheduled to appear before the Subcommittee are required to submit 50 copies of their prepared statement to the full Committee office, Room 1102 Longworth House Office Building, by close of business, Friday, June 17, 1983. Failure to comply with this requirement may result in the witness being denied the opportunity to testify in person.

Written statements in lieu of personal appearance

For those who wish to file a written statement for the printed record of the hearing, five copies are required and may be submitted to John J. Salmon, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Room 1102 Longworth House Office Building, Washington, D.C. 20515, by close of business, July 1, 1983. An additional supply of statements for the printed record may be furnished for distribution to the press and public if supplied to the Committee office before the hearing.

APPENDIX C.—LIST OF WITNESSES TESTIFYING

MONDAY, JUNE 27, 1983—BEGINNING AT 10:00 A.M., ROOM 1100, LONGWORTH HOUSE OFFICE BUILDING

Panel

The Honorable Wilbur D. Mills.

Barry D. Karl, Norma and Edna Freehling, Professor of History, University of Chicago.

Panel

U.S. Department of the Treasury: the Honorable John E. Chapoton, Assistant Secretary for Tax Policy.

Internal Revenue Service: James I. Owens, Acting Commissioner, accompanied by S. Allen Winborne, Assistant Commissioner, Employee Plans and Exempt Organizations.

Panel

The Honorable Neil F. Hartigan, Attorney General, State of Illinois.

James Cordi, Deputy Attorney General, State of California.

Jonathan Silberman, Section Chief, Not-For-Profit Organizations Section, Charities, Trusts and Estates Bureau, Office of the Attorney General, State of New York.

Council on Foundations: James Joseph, President and Chief Executive Officer.

Panel

Independent Sector: Brian O'Connell, President.

National Committee for Responsive Philanthropy: Robert Bothwell, Executive Director.

Waldemar A. Nielsen, New York, New York (Consultant and author of "The Big Foundations").

Panel: Grantees

American Red Cross: John L. Currin, Counselor and Secretary.

Children's Defense Fund: Marian Wright Edelman, President.

Focus Hope (Detroit, Michigan): Father William T. Cunningham, Executive Director.

Enterprise Foundation: Edward L. Quinn, President, accompanied by Michael Sanders.

The Heritage Foundation: Edwin J. Feulner, Jr., Ph. D., President.

TUESDAY, JUNE 28, 1983—BEGINNING AT 10:00 A.M., ROOM 1100, LONGWORTH HOUSE OFFICE BUILDING

Panel

The Honorable Fortney H. (Pete) Stark, M.C., California.

The Honorable Bill Frenzel, M.C., Minnesota.

The Honorable James M. Shannon, M.C., Massachusetts.

The Honorable Ralph Regula, M.C., Ohio.

The Honorable Mickey Leland, M.C., Texas.

The Honorable Richard C. Shelby, M.C., Alabama.

United States General Accounting Office: John Finch, Associate Director.

Panel

Institute for Research on the Economics of Taxation: Norman B. Ture, Chairman of the Board.

Malcolm L. Stein, Esq., Partner, Roberts & Holland, New York, N.Y.

Arthur Andersen & Company: Joseph J. DioGuardi, Tax Partner.

American Bankers Association: J. Stoddard Hayes, Member, Trust Taxation Committee (Vice President, Wilmington Trust Co.).

Panel: Foundation managers

David E. Rogers, M.D., President, the Robert Wood Johnson Foundation.

Roger W. Heyns, President, the William & Flora Hewlett Foundation.

William L. Bondurant, Executive Director, Mary Reynolds, Babcock Foundation, Inc.

James P. Shannon, Vice President and Executive Director, General Mills Foundation.

Marjorie Powell Allen, President, the Powell Family Foundation.

Panel: Grantees

United Negro College Fund: Chris Edley, President.

Center for Community Change: Pablo Eisenberg, President.

National Puerto Rican Coalition, Inc.: Millie Torres, Chairperson, accompanied by Louis Nunez, President.

William F. Ryan Health Center: Barbara Minch.

Panel: Regional associations of foundations

Southeastern Council of Foundations: Robert H. Hull, Executive Director.

Donors Forum of Chicago: Eleanor P. Petersen, President.

Council of Michigan Foundations: Dorothy A. Johnson, Executive Director.

Associated Grantmakers of Massachusetts, Inc.: Janet C. Taylor, Executive Director.

Hospital Corporation of America: Donald S. MacNaughton, Chairman of the Board, accompanied by the Honorable Wilbur D. Mills, Counsel.

THURSDAY, JUNE 30, 1983—BEGINNING AT 10:00 A.M., ROOM 1100, LONGWORTH HOUSE OFFICE BUILDING

Vernon Jordan, Trustee, the Rockefeller Foundation.

American Bar Association, Section of Taxation: M. Bernard Aidinoff, Chairman, Section of Taxation.

Panel: Public charity—private foundation definitions

The Strong Museum (Rochester, New York): William T. Alderson, Director.

The Mariners' Museum (Newport News, Virginia): William D. Wilkinson, Director.

The Merrimack Valley Textile Museum (North Andover, Massachusetts): Thomas W. Leavitt, Director.

Panel: Public charity—private foundation definitions

Linda Hall Library (Kansas City, Missouri): Larry X. Besant, Librarian.

Mercantile Library (St. Louis, Missouri): James M. Canavan, Jr., President.

James Jerome Hill Reference Library (St. Paul, Minnesota): Dr. Virgil F. Massman, Executive Director.

St. Louis Mercantile Library Association: Michael N. Newmark, Counsel.

Panel: Public charity—private foundation definitions

The Hutton Settlement Children's Home (Spokane, Washington): Robert K. Revel, Administrator, introduced by the Honorable Tom Foley, M.C., Washington.

Howard Memorial Fund: Monroe D. Dowling, President.

Jewish Foundation for the Education of Women: Charles J. Tannenbaum, President.

Panel: Public charity—private foundation definitions

The Robert A. Welch Foundation: John S. Nolan, Counsel.

URANTIA Foundation: Quin R. Frazer, Counsel.

Gardner, Carton & Douglas (Chicago, Illinois): William H. Roach, Jr., Esq. and Bernadette M. Broccolo, Esq.

Panel: Excess business holdings—divestiture requirement

Sheldon S. Cohen, Cohen & Uretz, Washington, D.C.

Norman A. Sugarman, Partner, Baker & Hostetler, Washington, D.C.

John D. and Catherine T. MacArthur Foundation: Dr. John E. Corbally, President.

W. K. Kellogg Foundation: Dr. Russell G. Mawby, President, accompanied by James W. Riddell, Counsel, and introduced by the Honorable Howard Wolpe, M.C., Michigan.

Panel: Excess business holdings—divestiture requirement

Altman Foundation: John S. Burke, Jr., President and Trustee.

Houston Endowment, Inc.: Walter P. Zivley, Counsel.

The Day Trust: Deane C. Avery, Trustee, and Publisher of the New London Day.

Public Welfare Foundation, Inc.: C. Davis Haines, President.

Panel: Excess business holdings—divestiture requirement

El Pomar Foundation: William J. Hybl, President.

A. Z. Wells Foundation: Melvin R. Brown, President, Wells & Wade Fruit Company.

H. E. Butt Foundation: Vester T. Hughes, Jr., Counsel.

Panel: Excess business holdings—divestiture requirement

Otto Bremer Foundation: Robert J. Reardon, Trustee, accompanied by Sherman Winthrop, Counsel.

Morris and Gwendolyn Cafritz Foundation: Eugene T. Rossides, Counsel.

The Hauss-Helms Foundation, Inc.: James E. Weger, President.

Panel

Murphy Motor Freight Lines: Barry A. Gersick, Counsel.

Clara Abbott Foundation: Dr. Charles S. Brown, Vice President.

Mobil Foundation, Inc.: J. Keith Nolan, Counsel, accompanied by Philip R. Brown, Property Manager.

APPENDIX D.—SUMMARY OF TESTIMONY

MONDAY, JUNE 27, 1983

HONORABLE WILBUR D. MILLS
COUNSEL, SHEA & GOULD (WASHINGTON, D.C.)

Mr. Mills was elected to Congress in 1938 and served until his retirement in 1977. He became Chairman of the Ways and Means Committee in 1958, and it was during his chairmanship that the basic provisions of the Internal Revenue Code governing the tax treatment of private foundations were enacted.

In his testimony Chairman Mills concentrated upon the historical development of the foundation provisions of the tax law, noting that some allegations of misuse of the foundation mechanism were justified and expressing the opinion that the 1969 law had generally worked well in eliminating such abuses. Nevertheless, he felt the law should be re-examined and that in some respects it might be too rigid. While he offered no specific suggestions for change, he indicated he might do so later. In response to questions the former Chairman expressed the opinion that he could see no reason for continuing the different contribution caps for private foundations and public charities and had no objection to the use of foundation money for voter registration activities.

BARRY D. KARL
NORMAN AND EDNA FREEHLING PROFESSOR OF AMERICAN HISTORY,
UNIVERSITY OF CHICAGO

Professor Karl is a noted historian and author of books and articles on public administration and private philanthropy. He is currently working on a comprehensive history of private foundations. Professor Karl's testimony centered on his view of the historical function of foundations in America, emphasizing their function as experimenters, providing innovative policy options to government. While he made no specific recommendations, Professor Karl said (1) that he viewed voter registration as a proper foundation function; (2) that lobbying limits did inhibit some research activities; and (3) that he favored increased availability of information to the public about foundation activity.

JOHN E. CHAPOTON
ASSISTANT SECRETARY FOR TAX POLICY,
U.S. DEPARTMENT OF THE TREASURY

Mr. Chapoton indicated that the Treasury supported changing the law (1) to permit a 5-year carryover for excess contributions to private foundations; (2) to grant administrative discretion to extend the 5 year disposition period for excess business holdings acquired by gift or bequest, where there are exceptionally large and complex gifts; and (3) to limit the definition of family member contained in the disqualified persons provisions. He also indicated that, while the Department was not yet willing to support other changes, it would review (1) the possibility of some increase in the 20 percent of adjusted gross income limit on deductions for contributions to private foundations; (2) the possibility of reducing the 2 percent excise tax; (3) the possibility of an exemption from the 10 percent public support rule, where other criteria of public responsiveness are met; and (4) the possibility of specific exceptions to the imposition of first tier penalty taxes, as opposed to a general provision for abatement.

Mr. Chapoton emphasized Treasury's view (1) that the provisions enacted in 1969 had worked well in preventing the abuses of the foundation mechanism which prompted its enactment, and (2) that the 1969 statute was an improvement over prior law in its use of penalty taxes, as opposed to loss of tax exempt status, for foundation abuses and in providing clear, administrable guidelines for foundation conduct. For these reasons, more substantive changes were not considered generally desirable.

Specifically, the Assistant Secretary expressed Treasury's opposition to eliminating the preferential treatment of deductions for contributions to public charities in the absence of substantial evidence of adverse effects on private foundations, stating that available data indicated a proportionate increase in giving to private foundations. He further noted that such preferential treatment was long standing policy, predicated upon the belief that public charities expended their receipts more directly and immediately for charitable purposes. Opposition to proposals to allow full fair market value deductions for gifts of appreciated property was predicated, in part, on the view that such preferential treatment should be limited to gifts to public charities and, in part, because of concerns of abuse through over-valuation of such assets. With regard to extension of the 5 year carryover for excess contributions to gifts to foundations, Mr. Chapoton said that there was no public or charitable interest served by forcing a contributor to use a series of smaller gifts rather than a single large one with a carryover for deductions.

The Assistant Secretary opposed any attempt to eliminate or provide exemptions from the excess business holdings provisions, maintaining that this limit was necessary to prevent conferring private benefits through a controlled business and insuring that foundation assets were invested and used for the purposes for which preferred tax treatment was granted. It was, he stated, impossible to draft and administer statutory provisions prohibiting every potential act of self-dealing; and the minimum distribution requirement did not prevent deferral of benefits to charity, since it depends upon valuation which may be questionable and can be satisfied by income from other investments. Mr. Chapoton also rejected the argument of some foundations that they should be allowed to retain control because potential buyers would not operate the business in the same manner, saying this only indicated that the present investment was not the best use of foundation assets.

Proposals to eliminate expenditure control requirements for small grants were opposed by the Assistant Secretary, who maintained that it was reasonable, not burdensome, to require a pre-grant inquiry, an agreement on the use of funds, and a report indicating that the funds were used for the purposes for which they were given. Such requirements were, in his view, sound practice a foundation should follow in any event, though he did suggest a review of the necessity of reporting these on the tax return.

While not proposing a change in the 2 percent excise tax, Mr. Chapoton indicated it seemed difficult to justify applying such a tax only to private foundations to finance administering IRS supervision of all tax exempt organizations.

JAMES I. OWENS
ACTING COMMISSIONER,
INTERNAL REVENUE SERVICE

Mr. Owens' testimony centered on IRS administration of the tax law applicable to private foundations, including regulations, rulings, audits and educational activities. In his view the 1969 law, as applied, has accomplished its objectives without stifling or inhibiting private philanthropic activity. He included summaries and examples of particular IRS efforts, including the fact that in the first five years after the enactment of the 1969 laws all foundations had been audited, and since January 1, 1975, four to ten percent audited annually. The acting Commissioner concluded that there had been substantial compliance with the law by private foundations.

A portion of Mr. Owens' testimony consisted of a summary of data reported to IRS with regard to foundations. Briefly, IRS files were said to contain 10,000 more private foundations at the end of calendar year 1982 than ten years earlier, though approximately half of that increase could be attributed to reclassification of pre-existing organizations. Reported value of assets was up from $35.3 billion in 1976 to $50.9 billion for the 1981 return year. Foundation revenue increased from $4 billion to $9 billion during the same return years.

MICHAEL J. HAYES
ASSISTANT ATTORNEY GENERAL,
STATE OF ILLINOIS

Mr. Hayes testified on behalf of Attorney General Hartigan of Illinois. Under the law of all but four States, the State Attorney General is responsible for administering the law governing charitable trusts and foundations. In Illinois some 3,500 foundations are registered with the Office of Attorney General. The laws of the State include many provisions found in federal law.

He expressed general satisfication with present laws as both fair and generally complied with by foundations. Mr. Hayes did suggest that a share of the penalty and the 2 percent excise taxes be returned to the state of principal office to be used for charitable purposes and administration of state law governing foundations. He also supported granting administrative discretion to extend the 5 year divestiture period for newly acquired gifts or bequests of excess business holdings and called for notification of appropriate state officials when audits are being conducted, so that supervisory efforts could be coordinated and administrative burdens reduced.

Remission of a portion of the penalty tax would, it was said, provide some reimbursement to the states for reduced endowments and charitable distributions by the penalized foundations. Sharing of the 2 percent excise tax with the states would, it was urged, enhance their ability to monitor the conduct of charitable organizations. Mr. Hayes reviewed the problems of the MacArthur Foundation, an Illinois corporation, which had received all the shares of stock of Bankers Life and Casualty, was faced with a November 30, 1983, divestiture deadline, and had made continual and unsuccessful efforts to comply at a fair sales price. In cases such as the MacArthur Foundation, where the holdings are large and complex, and good faith efforts have been made to comply, he believed some discretion to grant an extension should be given to avoid a distress sale and erosion of the endowment.

JAMES CORDI
DEPUTY ATTORNEY GENERAL,
STATE OF CALIFORNIA

Mr. Cordi testified on behalf of Attorney General Van de Kamp concerning the impact of federal tax law on California's supervision of foundation activities and their experience in California, where the law provides the Attorney General with extensive supervisory authority over some 38,000 active, registered charitable organizations, including some 3,200 private foundations with average total assets of about $4 billion. The primary function is to prevent abuse and to recover wrongfully diverted assets for public beneficiaries.

On the basis of California's experience Mr. Cordi suggested the Congress consider (1) amending the self-dealing provisions to provide guidelines or limits on administrative expenses and fees (possibly a specified percentage of annual income or qualifying distributions) paid to disqualified persons; (2) limits on conduit foundations to avoid delay in distributions and duplication of administrative expenses and fees; (3) requiring diversification of investment assets; (4) limiting penalty assessments to managers or disqualified persons or abatement of penalties against foundation assets; (5) changes in the divestiture provisions to include an unjust enrichment provision to require return of a portion of the profit to foundations of resales by disqualified persons within 5 years of a purchase from the foundation; to impose a continuing duty to make efforts to divest at fair market value, including the broadest possible market exposure; and to require annual reporting of these efforts on their return; and to permit an extension of time in certain cases.

In support of these proposals Mr. Cordi relied heavily on specific examples of problems arising from the California experience in foundation supervision. One example, used by Mr. Cordi in urging the Congress to consider limits on administrative fees and expenses paid disqualified persons, to examine the role of conduits, and to consider requiring diversification, was the W.M. Keck Trust and the W.M. Keck Foundation. The former, a testamentary trust, was bequeathed 10% of the stock of Superior Oil Co. for the benefit of the latter. The surviving son of the donor is sole living trustee, a director of the foundation, and former chairman and present director of Superior Oil. In his first two years as trustee Mr. Keck sought probate court approval of $1 million in fees each year ($2 million in total) for administering the assets of the trust and distributing its income to the foundation; $1.37 million was awarded, after negotiation and litigation by the State of California. An application for $859,000 was pending. He noted that here, as in other cases, the excess business holding provisions do not operate, family control of corporate stock is apparently a major concern, and prudent management would result in diversification.

Noting a civil action brought by his office to recover foundation funds used to pay first level penalty tax assessed for a grant to remote descendants of a donor by disinterested trustees, Mr. Cordi suggested penalties should not serve to reduce the flow to charity, but be aimed at individuals to deter misconduct, and indicated support for abatement in such cases.

The example of a California foundation holding stock in a steel company, a depressed industry, was cited by Mr. Cordi in support of his call for discretion to extend the divestiture period and require a continuing and reported effort to divest. He noted that in this case the trustees were not completely disinterested.

JONATHAN J. SILBERMANN
SECTION CHIEF, NONPROFIT ORGANIZATION SECTION
CHARITIES, TRUSTS AND ESTATES BUREAU
OFFICE OF NEW YORK STATE ATTORNEY GENERAL

Mr. Silbermann's office is responsible for ensuring proper administration of charitable assets in New York, where approximately one-third of the nation's foundations are based. He expressed the view that the 1969 act generally reflects the principles of common law, reinforces the fiduciary responsibility of foundation managers, and assists the states in their supervision of foundation conduct.

Mr. Silbermann indicated general support for the 1969 act, but he did call for more information sharing by IRS with appropriate state authorities, including audits and correction letters where no tax or penalty is assessed. He noted that privacy concerns are not as great since private foundation returns are, by law, available to the public and that under state law in New York and other jurisdictions the Attorney General possesses the rights of a member and director of a private foundation. While implicitly suggesting some modification of § 6104(c) of the Internal Revenue Code, no specific language or guidelines were offered.

JAMES JOSEPH
PRESIDENT AND CHIEF EXECUTIVE OFFICER
COUNCIL ON FOUNDATIONS

Mr. Joseph was Undersecretary of the Interior from 1977 to 1981; has served as the chief executive officer of three independent foundations; has served as chairman of the United States delegation to a number of United Nation conferences; taught at Yale; was Vice President and Assistant to the Chairman of Cummins Engine Co.; has served as a trustee or director of the Council on Foundations, Union Theological Seminary in New York, Opportunity Funding Corporation, Pitler College and Atlanta University; and is presently chairman of the presidentially-appointed Commission on the Northern Marianas.

The Council on Foundations was founded in 1949 and now has over 1000 members. Its membership consists of grantmaking institutions, and the council's major goals are to promote effective grantmaking, to encourage and support collaboration among grantmaking institutions, to encourage a supportive environment for philanthropy and to promote the development of new foundations.

In his testimony Mr. Joseph discussed the history of foundations and their ability to provide assistance for projects with potential long range results, as opposed to responding to more contemporary and continuing needs, and their capacity to adjust to newly emerging needs with innovative techniques. This capacity distinguishes private foundation from government programs and established charitable agencies, both with considerably less freedom to redirect resources or concern for long range solutions. A number of specific examples are offered, such as the grants to Dr. Salk for polio vaccine research; establishment of some 20 emergency loan and grant funds in the past 2 years to provide short term, emergency assistance for the new poor in need of food, health care, shelter, and fuel in response to cutbacks in government programs and increasing unemployment and recession. He emphasized that, because of their size, foundations could not be expected to fill the gap left by reductions in federal domestic programs, noting that gifts by private foundations in 1982 constituted little more than 5 percent of total contributions to charitable endeavors and that foundation assets in 1982 were less than the amount contributed to charities during that year and less than one third the budget for the Department of Health and Human Services.

Mr. Joseph concluded that the 1969 act, despite initial concern by foundations, generally worked well in limiting abuses and preventing the mechanism from being used for noncharitable purposes. Nevertheless, he contended, present law contained impediments to this form of private philanthropy which are not needed to prevent abuse and should be altered or eliminated. In support of his contention he questioned some of the data presented by IRS. For example, IRS listed approximately 33,000 foundations but according to data supplied the Center there are about 22,500 active, grantmaking foundations. According to Mr. Joseph the IRS included thousands of burned out public charities, and the birthrate of private foundations has decreased. 759 foundations with over $ 1 million in assets were created in the 1960's compared to 255 in the 1970's, according to Mr. Joseph. He also maintained that contributions as a percentage of gross national product decreased 50% percent from 1969 to 1981, and foundation assets, adjusted for inflation, had declined 26 percent during the same period.

Against this backdrop he called for the enactment of H.R. 3043, which would extend to donations to private foundations the same treatment accorded lifetime gifts to public charities; increasing the ceiling on deductions; allowing full fair market value deductions for gifts of appreciated property; and providing a carryover for excess contributions. He also called for: 1) consideration of repeal of the 2 percent excise tax; (2) extending the divestiture period for newly acquired excess business holding or administrative discretion to grant extensions; 3) limiting the definition of family member (disqualified persons) to children and grandchildren of substantial contributors; 4) permitting foundations to rely on IRS determinations of a grantee's tax qualified status for purposes of expenditure responsibility requirements; 5) eliminating expenditure responsibility for small grants; 6) providing for abatement of first level penalty taxes where the act was due to a good faith error or omission and corrected in the statutory period.

With regard to the 2 percent tax, Mr. Joseph noted that it reduced money available for grants (as did the first level penalty tax), while generating many times more money than needed to supervise private foundations. Changes in the expenditure responsibility rules it was urged, would eliminate administrative burdens and costs which generally confirm the IRS determination or serve as impediments to seed money grants for small scale activities. The record keeping burden of tracking remote lineal descendants was cited in support of changing the definition of family member. Finally, Mr. Joseph noted the Council on Foundations had repeatedly decided against recommending repeal of the excess business holdings provisions but did believe the 5 year limit on disposition of newly acquired holdings placed foundations at a bargaining disadvantage with prospective buyers, who might prolong negotiations and use the pressure of a deadline to gain a better deal.

BRIAN O'CONNELL
PRESIDENT OF INDEPENDENT SECTOR

Mr. O'Connell has served as President of Independent Sector since its inception in 1980. Previously he headed the Coalition of National Voluntary Organizations and the National Council on Philanthropy and served as Executive Director of the National Mental Health Association. Independent Sector is an organization of some 500 national, voluntary organizations, foundations, and business organizations, working together to promote and improve charitable activities and communication within the private sector and between the private and governmental sectors.

He stressed the diverse nature and interests of foundations and the importance of preserving that diversity and the freedom to be different and see things differently, as a creative mechanism. While Independent Sector had not yet taken an official position, its Government Relations Committee had studied H.R. 3043 and unanimously recommended its passage.

ROBERT BOTHWELL
EXECUTIVE DIRECTOR OF THE NATIONAL COMMITTEE FOR RESPONSIVE PHILANTHROPY

The National Committee for Responsive Philanthropy is a coalition of prospective donees/grantees from new organizations with non-traditional agendas. These groups are concerned about the failure of foundations to respond to needs of newly emerging organizations with new concerns and the lack of accountability of foundations to the public. Because they are diverse and independent, they could provide new initiatives in solving social problems, offering alternatives, and recognizing and meeting new needs.

Mr. Bothwell does not believe foundations are as vital and innovative as they could or should be, and attributes this to the fact that foundation boards are generally drawn from a very narrow segment of society and foundations are not easily accessible to potential grantees. In support of his contentions Mr. Bothwell cited a number of studies, national and regional, which concluded that a very small portion of foundation money was going to programs benefitting minorities (blacks, Hispanics, native Americans or women) or to "new grantees: (those not previously supported by the foundation). Other studies were cited to show that minority representation on foundation boards was relatively rare and to demonstrate that foundations which gave money to minority activities were much more likely to include minorities on their board or staff. He cited their own study suggesting that many foundations have no listed phone number, and a GAO study indicating a high rate of tax compliance by foundations but a poor record in supplying information required by IRS and the law which would give grant seekers useful knowledge as to whom grants were made and why.

Specifically, Mr. Bothwell called upon Congress to urge IRS to enforce reporting requirements, to amend the law to require reporting of the racial/ethnic and sexual composition of the board and staff on Form 990PF, to require larger foundations to make simple annual reports available at cost and advertise their availability in the largest circulating community newspaper and to require larger foundations to hold annual public meetings of their trustees.

In addition, Mr. Bothwell identified certain other features of existing law which he believed impeded innovation and responsiveness to emerging or novel needs or programs. These included expenditure responsibility requirements for small grants which, he maintained, have had a chilling effect on seed grants. Mr. Bothwell suggest eliminating the requirement for grants of less than $5,000. He also suggested that lobbying limits discouraged foundation funding of certain activities which might involve lobbying and called for an amendment to the law to clarify this limit. He also suggested that if contribution deduction provisions for foundations were liberalized, the new tax incentives should be made only where the foundation has complied with the recommendation on responsiveness and where the foundation had agreed to a payout of substantially more than 5 percent, had no excessive trust or staff compensation, had diversified its board, and diversified its assets. He questioned whether any decline in the birthrate of major foundations could be attributed to the 1969 act, noting that the downward trend in their birthrate began ten years earlier, and suggested that the present 5% payout requirement was inadequate to meet present needs and based on questionable assumptions as to the necessity of protecting foundation assets from destruction by invasion.

WALDEMAR A. NIELSON
CONSULTANT AND AUTHOR,
NEW YORK, NEW YORK

Mr. Nielson is a consultant on corporate social policy, former Special Assistant to the Secretary of Commerce on the Marshall Plan, a former officer of the Ford Foundation and author of several books on foundations. He indicated he shared the concerns of those who emphasized the importance of the freedom and independence of foundations and those who felt the foundation community was not as accessible and responsive to all groups in society as it should be.

In general he viewed the 1969 Act as a well conceived and effective response to real abuses which were undermining the credibility and presitge of foundations. However, he could see no reason to distinguish between the deductions for gifts to grant-making and operating foundations. Specifically, he suggested establishment of a national endowment for philanthropy with some of the 2 percent excise tax money to collect, evaluate and disseminate information about foundations and other private sector activities.

JOHN L. CURRIN
COUNSELOR AND SECRETARY
THE AMERICAN RED CROSS

Mr. Currin testified generally about the work of the American Red Cross and the assistance it received from foundations for ongoing programs and disaster relief, noting that about 1.6 percent of its ongoing budget is from this source, that over one-sixth of the contributions in its last nationwide disaster fund campaign came from foundations. He cited other instances of foundation support for international and local disaster relief efforts of Red Cross and indicated general satisfaction with past response by foundations to Red Cross needs. No specific suggestions for change were made.

MARIAN WRIGHT EDELMAN, PRESIDENT
CHILDREN"S DEFENSE FUND

Ms. Edelman founded the Fund and has been its president from the beginning. She formerly served as director of the NAACP Legal Defense and Education office in Jackson, Mississippi and as a member of the Board and counsel to the Child Development Group of Mississippi. She has and continues to serve on a variety of other boards of institutions concerned with education, children, and social problems. The Children's Defense Fund is a national public charity designed to promote concerns for the needs of children and their families as an important element in the nation's public policy agenda. It is particularly concerned with poor, minority, handicapped and homeless children.

Ms. Edelman summarized the work of the Children's Defense Fund, including research, publications, and follow up efforts and programs. the subjects of these efforts have included children not enrolled in shcool, school suspensions, educational rights for handicapped children, parental access to school records, maternal and child health services for the poor, mental health, homeless children, and child care and family support services. She emphasized the importance of foundation grants in getting the organization started and enabling it to build a track record which would attract broader financial support. Noting that no government money had ever been accepted, she indicated that foundations continued to provide almost 80 percent of the Fund's budget, and that they also provided assistance in the form of information and expertise. The Foundation has a for-profit subsidiary (taxable), which does development work in this area and provides funds for the Foundation.

FATHER WILLIAM R. CUNNINGHAM
EXECUTIVE DIRECTOR
FOCUS: HOPE, DETROIT, MICH.

Focus: Hope is a civil and human rights organization working in the Detroit area with 200 employees and 23,000 volunteers. Father Cunningham summarized its work and the assistance from foundations and the private sector. Its activities include a food distribution program which provided food for over 53,000 needy mothers, infants, and preschoolers in May of 1983. Focus: Hope operates its food program from a building donated by a charitable trust and local bank, with a computerized record keeping system for food inventory and registration of needy families donated by shared grants from foundations. It has also produced video tape programs on nutrition which are shown on large screen monitors in its food centers. The tapes were produced with equipment donated by a newspaper charity and foundation. With the combined assistance of foundations and corporations it has developed Focus: Hope Industry Mall and Machinist Training Institute, the largest center in the country for high skill training, new employment, and development of minority ownership in machine tool production. He also noted a pilot program to test distribution of food supplements to the elderly as a means of reducing medical costs, assisted by a foundation, and litigation to protect minority jobs. No suggestions for changing existing law were offered.

EDWARD L. QUINN, PRESIDENT
ENTERPRISE FOUNDATION

The Enterprise Foundation was created in 1981 by James W. Rouse, mortgage banker and real estate developer, to assist in providing housing for the poor. It seeks to develop housing groups and financing vehicles, combining low interest loans, mortgage guarantees, subsidies and other forms of financing and to develop a staff skilled in financing and rehabilitating low cost housing. While the foundation is new, it made grants or loans totaling over $2.3 million in the first half of 1983 and has received financial assistance from a numnber of private foundations, corporation from a number of private foundations, corporation and individuals. While offering no specific proposals, Mr. Quinn did endorse H.R. 3043 as a means of injecting new funds into existing foundations and encouraging creation of new ones.

EDWIN J. FEULNER, Ph.D, PRESIDENT
THE HERITAGE FOUNDATION

The Heritage Foundation is a public policy research institution located in Washington, D.C. Its president emphasized the importance of private philanthropy in supporting publication of different opinions on political and social issues, promoting diversity, and developing new ideas.

The witness urged repeal of IRC § 4943 (excess business holdings) and modification of the disqualified person rule. Dr. Feulner called for a "moving 2 percent" rule for determining who is a substantial contributor, so that if the individual's contribution no longer exceeded 2 percent of the foundation's assets, he (or she) would no longer be viewed as a substantial contributor. He also called for limiting disqualified family members to the grandchildren of substantial contributors and eliminating divorced spouses from coverage.

Dr. Feulner argued (1) that the excess business holdings provision was a barrier to creation of new foundations and injection of new capital into existing foundations, (2) that it is silly to view giving away assets as tax avoidance, and (3) that those who have earned and accumulated wealth should be free to promote their dreams within the broad limits of a charitable, religious, or educational purpose. Secondly, he maintained that there was no reason, particularly with a growing foundation, for a substantial contributor in its early years to remain so when, as a result of growth, his original contribution becomes a very small proportion of the total foundation assets. Further, he cites the problems of recordkeeping and innocent acts of self dealing which might result in his call for limiting the definition of disqualified family members.

TUESDAY, June 28, 1983

HONORABLE FORTNEY H. STARK
MEMBER OF CONGRESS (CALIFORNIA)

Representative Stark ought the Committee must decide whether social policy is better served by unlimited preservation of capital with a low level of income payout always available to meet society's needs or whether a limited life with a higher payout over a shorter time is preferable.

He endorsed consideration of limited life for foundations so that resources of each generation will be concentrated on the problems of that age and assure that capital, as well as income, will be spent for the purposes intended by the benefactor. If a limited life approach is taken, attention should be given to encourage the formation of new foundations to replace those that would expire over time.

Representative Stark suggestd that the subcommittee should send clear signal to the foundation community that trustee compensation should not be excessive and that foundations have a duty to be watchful and conservative in setting levels of compensation. He illustrated his concern with the report that the W.M. Keck Foundation had paid a single trustee over $1 million a year.

In his view the subcommittee should not recommend any weakening of the I.R.C. §4943 divestiture requirement; he stated that most cases for exemption are without merit and mentioned specifically the Public Welfare Foundation, the Houston Endowment, the New London Day Foundation, and the Otto Bremer Foundation. Finally, Representative Stark indicated that one or two foundations that are attempting to comply with the rules may need short term relief from the time limits.

HONORABLE BILL FRENZEL
MEMBER OF CONGRESS (MINNESOTA)

Representative Frenzel endorsed H.R. 3043 and H.R. 974, which he sponsored.

He thought it was time to review the entire foundation laws in a leisurely and careful fashion.

In his view any tax distinction between contributions to private foundations and contributions to public charities ought to be eliminated. He also suggested modifying the definition of disqualified persons so that all lineal descendants were not included in the definition; abating first-tier penalty taxes in cases where the prohibited transaction was due to reasonable cause and was inadvertant; eliminating expenditure responsibility rules for grants totalling less than $15,000 per year; excluding all capital gains income from the excise tax; allowing investment expenses to be considered as qualifying distributions for purposes of the payout requirement.

Specifically, he asked that the Otto Bremer Foundation be given extra time to comply with the divestiture requirements and stated that the Olin Foundation, which owns and operates Federal Cartridge Corporation, requests an exemption from the divestiture requirements, which he believed merits special attention, at least an extension, from the subcommittee.

HONORABLE JAMES M. SHANNON
MEMBER OF CONGRESS (MASSACHUSETTS)

Representative Shannon endorsed H.R. 3043 to encourage the birth of new foundations, to encourage privately funded philanthropy, and to eliminate the distinctions in treatment of gifts to private foundations and public charities. He believed the restrictions on private foundations addressed in the 1969 Act are sufficient to guarantee that all funds given to private foundations are used for charitable purposes; and therefore, the restrictions on giving to private foundations should be repealed.

Four additional technical changes in H.R. 3043 were endorsed: limiting the definition of family member to children and grandchildren of disqualified persons; allowing the foundation to rely on official IRS rulings recognizing the tax-exempt status of potential grantees; applying the detailed record-keeping and reporting requirements only when total grants to a particular grantee during a given taxable year exceed $15,000; and allowing the Secretary of the Treasury to abate first-level penalty taxes when a violation of the rules was due to a reasonable cause and was corrected within the statutory period.

He endorsed H.R. 2138 to make certain museums and libraries eligible for public charity treatment, believing private foundation rules were not intended to apply to organizations like museums and libraries with substantial public accessibility and accountability which also happen to have a large endowment. Representative Shannon suggested that present law places such organizations in the position of competing for public funding, which they do not need, in order to retain public charity status or accepting the restrictions of private foundation status. He mentioned the Merrimack Valley Textile Museum as a case in point.

HONORABLE RALPH REGULA
MEMBER OF CONGRESS (OHIO)

Representative Regula thought the law requires a more realistic definition of disqualified persons and urged the committee to consider revisions to I.R.C. §4943, particularly as it affects takeovers. He believed the existing law may favor takeovers of small businesses and is concerned about the impact on the communities.

HONORABLE MICKEY LELAND
MEMBER OF CONGRESS (TEXAS)

Representative Leland supported H.R. 2598 to permit the Houston Endowment and the Public Welfare Foundation to continue to own newspapers which they have owned for many years.

He remarked that Houston Endowment has given away more than $214 million since 1937, and expressed the fear that, if the Endowment must divest the *Houston Chronicle*, a large chain would buy the paper. Representative Leland believed that local ownership is superior to chain ownership, and that divestiture of the *Chronicle* would raise First Amendment issues by denying the Endowment its ability to own and publish a newspaper. He also believed that divestiture would not be in the public interest.

HONORABLE RICHARD C. SHELBY
MEMBER OF CONGRESS (ALABAMA)

Representative Shelby supported H.R. 2589 to permit the Public Welfare Foundation to continue to own three local newspapers in Alabama and South Carolina: Tuscaloosa News, Spartanburg Herald and Journal, and the Gadsden Times.

He believed that divestiture of these newspapers would result in chain ownership and further concentration of ownership of the media, that such concentration is not in the national interest, and that it would diminish the community participation and local charitable efforts of both the newspaper and the Public Welfare Foundation.

JOHN C. FINCH, ASSOCIATE DIRECTOR
U.S. GENERAL ACCOUNTING OFFICE

The primary purpose of the GAO testimony was to draw a statistical profile of the private foundation community. They analyzed foundation return information to determine the financial condition of private foundations and the part of foundation resources which are used for charitable purposes.

They found the number of private foundation increased from 14,865 in 1962 to 31,866 in 1981. The market value of private foundation assets increased from 1962 to 1981 from about $16.3 billion to $51 billion, although asset values declined slightly in recent years. Expressed in constant dollars the increase in value was much more limited.

Annual receipts increased from about $1.9 billion to $9.1 billion. Annual expenses increased from about $2.7 billion in 1974 to about $4.8 billion in 1981. Exempt purpose expenditures increased from about $1 billion in 1962 to about $3.2 billion in 1979. In 1974 foundations spent about 97 percent of their total receipts; in 1981 they spent about 53 percent. The receipts retained by private foundations roughly approximated the amount of donations they received.

The GAO statistical analyses did not permit them to reach conclusions as to whether foundations are properly balancing their operations between serving the public and meeting their own financial needs and whether there is a need for more or less regulation.

The GAO found that foundations complied well with the reporting requirements that the IRS has identified as being necessary for tax enforcement purposes; however, most foundations did not comply as well with information that is useful to the public because the IRS has not emphasized those requirements. Mr. Finch indicated that the IRS had agreed to strengthen its enforcement program.

The GAO had no specific recommendations, but Mr. Finch indicated that they would be happy to work with the subcommittee staff to develop some suggestions for improving the data collection process and to think about the kinds of information needed for effective oversight.

NORMAN B. TURE, CHAIRMAN OF THE BOARD
INSTITUTE FOR RESEARCH OF THE ECONOMICS OF TAXATION (IRET)

IRET is a public policy research organization, funded by corporations and foundations, which provides public information on tax policy issues. Mr. Ture served as Undersecretary of the Treasury for Tax and Economic Affairs under the Reagan Administration from February 1981 to July 1982.

Mr. Ture advocated repeal of both IRC §§4942 and 4943. He found little evidence for believing that the optimum distribution policy is one in which all or substantially all of a foundation's returns on assets are distributed currently. He believed that some foundations may have goals which would be better served by being able to accumulate income for a time. He stated that IRC §4942 exerts pressure to structure portfolios for a high current yield rather than for strong growth potential. Short of repeal, Mr. Ture believed that the minimum distribution rule should apply over a longer period than a year, for example, a 10- or 20-year period.

He suggested that justifications for the excess business holdings divestiture requirement are "iffy" in that he thought it unlikely that foundation involvement in a corporation's affairs would be detrimental to the corporation or to the foundation since the financial health of both is interdependent. Similarly, he dismissed the potential unfair competition argument, stating that §4943 would not limit opportunities for tax-free sources of finance. He felt that these possible benefits from present law were greatly outweighed by the fact that §4943 discourages creation of new foundations by contributions of controlling blocks of stock. He suggested repealing §4943 in order to remove constraints on financing new foundations.

MALCOLM L. STEIN, ESQ.
ROBERTS & HOLLAND

Mr. Stein is an attorney with Roberts & Holland in New York. He was a staff attorney in the office of the Assistant Secretary of the Treasury for Tax Policy from 1969 through 1971. In that capacity he assisted in drafting the 1969 legislation as well as proposed Treasury regulations on private foundations.

He endorsed H.R. 3043 for easing the limitations on charitable contributions, abating the first-tier penalties in certain situations, and relaxing the expenditure responsibility for small grants.

In addition, he believed that the 2 percent excise tax should be repealed or lowered to 1 or 1/4 percent because it collects more money than is necessary for auditing private foundations and reduces the flow of money to benevolent activities.

Mr. Stein proposed eliminating the excess business holdings rules or enacting a simple set of rules requiring foundations to divest themselves of effective control within a 20-year period, regardless of the holdings of disqualified persons. In his view the self-dealing rules and the 5 percent distribution requirement, plus State fiduciary responsibility requirements, amply protect the distribution of charitable assets to philanthropy. He believed that his suggestion is significant because he refrained from advocating repeal in 1973, but is now satisfied that the provision is unnecessary to ensure that assets are controlled for charitable uses.

Mr. Stein stated that the expenditure responsibility rules particularly burden operating foundations such as museums and libraries and suggests exempting grants to operating foundations and grants of less than $10,000 per grantee per year from the expenditure responsibility requirements.

JOSEPH J. DIOGUARDI, TAX PARTNER
ARTHUR ANDERSEN & COMPANY

Mr. DioGuardi is a tax partner in a Arther Andersen & Company with firmwide responsibility for the tax aspects of nonprofit organizations and charitable giving. The firm has over 3500 charitable organization clients, including private foundations. He represents the views of his firm, not any particular client.

His testimony pointed out that there are many kinds of private foundations: family foundations, large multi-purpose foundations, corporation foundations, community foundations, pass-through foundations, operating foundations, and satellite foundations formed by public charities. He believed that the sanctions developed to prevent abuse in one type of foundation act as deterrents to other types of foundations and that some sanctions are too harsh and create worse problems than the perceived abuses.

He proposed the following types of treatment for the various types of foundations he lists:

1. Family foundations (i.e. those that are founded, funded, and managed by a particular family) are most appropriately governed by the excess business holding and self-dealing rules because of the individual control inherent in this type of foundation. Recordkeeping, public inspection, and tax reporting requirements are the most burdensome for family foundations, and their relatively small size and high proportion of grants to public charities do not warrant these burdens.

2. Large multi-purpose foundations (i.e. similar to family foundations but the family usually does not remain involved, and management is conducted by unrelated persons) are similar to public charities except that they do not enjoy or seek public support. These foundations are unlikely to have self-dealing or jeopardizing investment problems.

3. Corporation foundations (i.e. founded and funded by a corporation) should be treated the same as public charities, with no special sanctions because of the public scrutiny afforded the donor-corporation.

4. Community foundations should retain their public charity status.

5. Operating foundations should be treated as public charities.

6. Satellite foundations of public charities should be treated as public charities.

He recommended easing the private foundation provisions and fine-tuning them to direct them at the type of foundation susceptible to the abuse; recommended treating pass-through, operating foundations, and satellite foundations as public charities; favored equalizing the treatment of gifts to private foundations and public charities. He supported modifying the self-dealing rules to return to the fair market value and prudent man standards, allowing transactions which are beneficial to the charity; proposed liberalizing the excess business holding rule, and at least allowing the sale of excess holdings at fair market value to disqualified persons without self-dealing penalties.

Mr. DioGuardi believed private foundations should have tax parity with public charities; opposed the excise tax on investment income; opposed the excise taxes on prohibited transactions; and recommended simplifying reporting and other administrative burdens, especially for smaller foundations.

J. STODDARD HAYES, MEMBER
TRUST TAXATION COMMITTEE
AMERICAN BANKERS ASSOCIATION

Mr. Hayes is a member of the Trust Taxation Committee of the American Bankers Association and is also a vice president of a bank in Delaware. He presented the views of a group which acts as professional trustees, often for charitable trusts.

His testimony summarized the substantial amount of time (5 to 7 hours) and cost (minimum $1150, not including trustee compensation) to prepare the simplest Form 990PF. He stated that if a 6.5% return is a reasonable yield for a diversified portfolio, a trust would have to have a corpus of over $400,000 before it can afford to pay both the costs of preparation of forms and trustee compensation. A trust of $200,000 to $400,000 can afford to pay the cost to prepare the 990PF, but the trustee must work for a reduced fee. A trust of less than $200,000 means that the trustee must pay part of the cost to prepare the 990PF and work for no fee.

He mentioned that the high costs of administering a charitable trust often discourage clients from setting up a charitable trust and suggested easing the burdens on private foundations where there is a low risk that prohibited transactions will occur.

For low risk cases, he would substitute for Form 990-PF the Form 1041 accompanied by a trustee's certification that the trust engaged in no prohibited transactions and distributed sufficient income to comply. He also suggested eliminating the 2% excise tax for these trusts. He would categorize as low risk: trusts with annual receipts of less than $25,000; trusts which have received no contributions within the last five years; and trusts which would qualify for IRC §509(a)(3) public charity status except for failing the "integral part test."

For other trusts, he suggested simplifying Form 990-PF by eliminating the public notice requirements where the trust instruments specify the distributions to be made; eliminating the computation of adjusted net income; replacing the balance sheet with a schedule of assets and liabilities; reducing the valuations from monthly to quarterly or annually for small trusts; allowing any reasonable valuation method consistently applied; and raising the minimum expenditure responsibility threshhold to $2500. He also proposed permitting the Commissioner to waive penalty excise taxes where the failure to comply is due to reasonable cause and not willful neglect.

DAVID E. ROGERS, M.D., PRESIDENT
THE ROBERT WOOD JOHNSON FOUNDATION

Dr. Rogers is chairman of the board of the Council on Foundations and president of The Robert Wood Johnson Foundation, which is the largest single private foundation source of health funding in the country.

Dr. Rogers' presentation made four points:

1. Statistics show that this country has made extraordinary progress in improving the health of its people and that foundations have had a vital role in that progress.

2. Private foundations fund only about .2% of all national health expenditures.

3. Private foundations have a special role in health affairs by acting as a source of public interest venture capital, providing seed money for long range future-oriented programs. Foster care for the frail elderly and the Kentucky Frontier Nursing Service are examples of programs funded by foundations. Foundations can provide money to test new ideas, to assist in expensive projects which are too narrow for public sector attention, and to provide continuity of ideas.

4. Foundations are doing a good job; foundations are an endangered species; and some of the impediments which hamper their maximum efforts ought to be removed.

He adopted the Council on Foundations positions, endorsing H.R. 3043 and opposing the repeal of the excess business holdings provisions of the 1969 Act.

ROGER W. HEYNS, PRESIDENT
THE WILLIAM & FLORA HEWLETT FOUNDATION

Mr. Heyns discussed two topics: the response of foundations to the current economic downturn and the role of private foundations in the field of education, using The William & Flora Hewlett Foundation as an illustration.

He stated that foundations have had three types of responses to the decrease in Federal funding in the current economic difficulties: emergency grants; helping social organizations and social service agencies improve their management, funding, and broaden their base of support; and identifying basic problems requiring long-range attention, e.g. youth unemployment, teenage pregnancies, community development

He noted that The William & Flora Hewlett Foundation devotes about 30% of its annual grants budget to education. The foundation does not fund operating needs but attempts to build educational capacity. It aids private black colleges; it funds research libraries and is helping the Council on Library Resources establish a national bibliographic network; it supports a program designed to increase the number of minority students in science and engineering.

The foundation is also interested in arms control, defense strategy and disarmament.

The foundation tries to maintain some stability in making grants from year to year, but some changes are made after the annual reexamination.

WILLIAM L. BONDURANT, EXECUTIVE DIRECTOR MARY REYNOLDS BABCOCK FOUNDATION

Mr. Bondurant is executive director of the Mary Reynolds Babcock Foundation of Winston-Salem, North Carolina. He is also Treasurer of the Council on Foundations and has served as chairman of the Southeastern Council on Foundations. He represents the views of a middle-sized foundation, capitalized with $15 million thirty years ago. The foundation has donated over $48 million in grants and is worth approximately $40 million.

He believed that the Government ought to keep foundations alive because they provide resources to deal with human needs as they change over the long term. Foundations with broad latitudes to meet human needs can move quickly to address needs that are not being filled by the Government or private citizens. He stated that foundations provide a healthy option for individuals to return their wealth to their communities. He believed that foundations encourage diversity and bring out the best in people.

JAMES P. SHANNON, EXECUTIVE DIRECTOR GENERAL MILLS FOUNDATION

Mr. Shannon is Vice President of General Mills Company and Executive Director of the company foundation and was asked to testify about corporate foundations. He has experience as a manager of a corporate, a family, and and community foundation since 1969.

Mr. Shannon stated that a typical corporate foundation pays out in grants each year money given to it by its parent company from profits realized by the company in the preceding fiscal year. He noted that in three of the past five years the General Mills Foundation paid out more money in grants than the amount given to it by its parent company. This was possible because the foundation also paid out the interest it earned on temporary investments. He mentioned that corporate foundations must also answer to shareholders for use of the company's profits.

He recommended that the Congress ease the expenditure responsibility for grants to small, recently established, but promising,health care, educational, cultural, and social service agencies, in view of the urgent current need for support of the nonprofit sector.

Mr. Shannon suggested that the excise tax on investment income be lowered to collect only what is necessary to pay for IRS oversight of compliance with the 1969 Act.

In his view the excess business holdings question is a delicate area and any decisions about relief for individual foundations should be predicated on the individual merits of each foundation's particular situation.

MARJORIE POWELL ALLEN, PRESIDENT THE POWELL FAMILY FOUNDATION

Ms.Allen is president of a small Kansas foundation founded by her father. The foundation has approximately $25 million in assets, a large portion of which is Yellow Freight Systems stock.

She discussed certain provisions of the 1969 Act which she believes have adversely affected the vitality and growth of private foundations. She cataloged the following reasons for the decline of private foundations:

1. Reporting and recordkeeping requirements are onerous for a small foundation with a small staff. She supported the establishment by the IRS of the Form 990 Advisory Comittee to evaluate and simplify the Form 990.

2. Expenditure responsibility requirements are so great that the small foundation lacks the staff to meet the requirements and often make grants only to public charities. She endorsed the expenditure responsibility provisions of H.R. 3043, exempting grants of $15,000 or less.

3. Divestiture requirements are severe and limit the creation of new foundations. She supported the extension of time for divestiture and suggested finding some other means of preventing abuses other than a mechanical test of stock ownership.

4. The penalty taxes for violations of the prohibited transaction rules are severe and are applied automatically. She favored the provisions of H.R. 3043 which would give the Secretary of the Treasury authority to abate the first level penalty in cases where he deems the violations were made in good faith and were corrected within a specified period.

5. She also listed the less favorable treatment for income tax purposes of gifts to private foundations.

CHRISTOPHER F. EDLEY, PRESIDENT
UNITED NEGRO COLLEGE FUND

Mr. Edley is president of the United Negro College Fund, America's first united educational chest and the official fund-raising body for 42 of 47 private black senior colleges in the country.

Mr. Edley testified about the importance of foundations on the history of black higher education. The UNCF was created by grants from two foundations in 1944. He stated that foundation grants and funding have had the most profound impact on the fund's growth, funding their most experimental and innovative programs, sustaining the general operating costs of the member schools, and providing scholarship funds to students.

He mentioned that UNCF receives 1100 contributions per year from foundations. He urged the committee to remember that there are many causes in America which depend on the existence of foundations.

PABLO EISENBERG, PRESIDENT, CENTER FOR COMMUNITY CHANGE
CO-CHAIR, NATIONAL COMMITTEE FOR RESPONSIVE PHILANTHROPY

Mr. Eisenberg is president of a national organization which provides technical assistance and other support to low income and minority community based organizations throughout the country. His organization is dependent on foundation funding.

He indicated that most foundations are not innovative in grantmaking, avoiding grass roots, neighborhood, activist and socially oriented organizations and recommended changes he felt would encourage more active and innovative grantmaking.

Mr. Eisenberg suggested that Congress ensure that foundations provide sufficient information about their operations to the public and to potential grantees by requiring certain size foundations to issue annual reports which would include certain minimal information.

He proposed removing some restrictions on philanthropic innovation and risk taking by removing the expenditure responsibility requirements for all grants of less than $20,000.

He asked Congress to issue a clear statement, written into law, that foundations can make general grants to public charities even though some of the resources of these organizations may legitimately be used for lobbying. Similarly, he advocated eliminating the five-state ruling which prevents local foundations from getting involved in local voter education and registration.

Finally, the witness called for a reassessment of the formula for the minimum payout. Mr. Eisenberg proposed a minimum payout of 5% plus a percentage of the profits over 5%, perhaps 25 or 50%, which he believed balances the needs of the foundation to build assets with their obligation to spend money for the purposes for which they were created.

MILLIE TORRES, CHAIRPERSON
THE NATIONAL PUERTO RICAN COALITION, INC.

The coalition is a membership organization composed of organizations and individuals interested in promoting the political, economic and social well-being of Puerto Ricans in the United States and Puerto Rico.

The coalition believed that there is a need for foundations to be more responsive to minority needs and concerns. Foundations have not achieved their potential in supporting the viability of Puerto Rican institutions.

Ms. Torres suggested that the foundations ought to include minority members on their staffs and boards of directors. She believed this would make foundations more responsive to the needs of the less privileged groups.

Ms. Torres also proposed adopting stricter disclosure and accountability requirements. She believed the Form 990-PF does not go far enough. She would like to see information such as the racial and ethnic composition of staff and board of directors.

She suggested that Congress require the IRS to compile an annual report on the impact of private philanthropic giving, similar to the report on I.R.C. §936. This report would inform policy makers, charitable organizations, and the general public about private foundations.

She indicated that available research makes it evident that Hispanics have benefitted little from foundation money, and most foundations ignore the needs of the Puerto Rican community.

ROBERT H. HULL, EXECUTIVE DIRECTOR SOUTHEASTERN COUNCIL OF FOUNDATIONS

Mr. Hull is executive director of the Southeastern Council of Foundations, a regional association of some 225 grantmaking foundations in the southeastern part of the United States, and the chairman of the Committee of Regional Associations of Grantmakers of the Council on Foundations.

Mr. Hull discussed regional associations of foundations, stating that there are currently 17 formally organized regional associations with approximately 1500 member organizations. He observed that the impetus for establishing most regional associations was the Tax Reform Act of 1969. The purpose of these associations is to inform members of legislative and regulatory developments, to aid compliance, to improve efficiency of foundation operations, to analyze local needs, to collaborate in grant efforts, and to inform the public about the interests and activities of foundations.

ELEANOR P. PETERSEN, PRESIDENT DONORS FORUM OF CHICAGO

Ms. Petersen is President of the Donors Forum of Chicago, an association of 100 independent family and corporate foundations and corporate giving programs.

She described how regional associations are encouraging foundations to become more open with their communities and with grantseekers by activities such as holding meetings, placing grantseekers on the boards of these associations, publishing membership directories, and establishing libraries of information and technical assistance.

DOROTHY A. JOHNSON, EXECUTIVE DIRECTOR COUNCIL OF MICHIGAN FOUNDATIONS

Ms. Johnson did not discuss the Council of Michigan Foundations. Her topics were how foundations comply with the law and how they make grants.

She indicated that GAO had testified at hearings held by the Subcomittee on Commerce, Consumer and Monetary Affairs that 98% of private foundations comply with the tax portions of the law. She claimed that regional associations assist foundations in completing the required forms and in fulfilling the "spirit of the law" requirements, especially about making information available to the public.

She indicated that many regional associations, including the Council on Michigan Foundations, are supporting the H.R. 3043 because it will increase charitable resources available to meet increasing needs, while also lessening the administrative burden of foundations for expenditure responsibility grants, plus it will remove provisions which have affected the growth of foundations.

Ms. Johnson stated that as more information becomes public, foundations see better grant proposals for more needs with fewer resources. She noted that the foundation payout rate is high in Michigan—7.8% in 1981 and that the Michigan council publishes a directory. She commented that foundations and associations put on many useful programs throughout the year all over the country.

JANET C. TAYLOR, EXECUTIVE DIRECTOR
ASSOCIATED GRANTMAKERS OF MASSACHUSETTS, INC.

Ms. Taylor illustrated the role of regional associations in coordinating the efforts of various foundations and corporations--facilitating communication and promoting a spirit of cooperation. She mentioned that regional associations can give foundations objective assessments of problems and help develop a framework for responding to a perceived need.

She included as examples: a Chicago food depository which involved coordinating gifts of food in-kind, cash, and technical assistance; a summer activities program for Boston youth; Michigan foundations' responses to the economic problems of that state; a mental health project in Texas funded by five foundations; a project assisting the homeless in New York City involving the efforts of 18 foundations; a Kansas City health care project serving low-income elderly and high-risk youth; and a collaborative funding project for medium-sized foundations which cannot provide full funding for a project.

A final example of creative approaches to problem-solving was the emergency loan fund which originated in San Francisco, providing ways to recycle charitable dollars when an organization was experiencing cash-flow problems.

DONALD S. MACNAUGHTON, CHAIRMAN
HOSPITAL CORPORATION OF AMERICA

Mr. MacNaughton is chairman of the board of Hospital Corporation of America. HCA owns, operates and manages more than 350 hospitals in the United States and abroad. HCA is a for-profit corporation and it pays taxes.

Mr. MacNaughton explained that HCA has set up a corporate foundation. HCA would like to fund the foundation with a stock option to purchase one million shares of HCA stock within 10 years for the price of the stock on the date of the granting of the option. HCA would then give the foundation $3 million a year, so that within 10 years the foundation could either buy the appreciated stock for $30 million or it would have a capital fund of $30 million.

He explained that the self-dealing rules would not permit the foundation to exercise the option to buy the stock, although the granting of the option was not a prohibited transaction. He added that the transaction would be permissible under current law if HCA had been able to donate $30 million at one time rather than granting an option with annual contributions of smaller amounts. He asked for a modification of the self-dealing rules to permit the proposed transaction and offered to work with the staff and Treasury to develop appropriate language.

In response to questions, he indicated that he thought that under present law the foundation could sell the option to another foundation and realize income from the option in that fashion.

THURSDAY, June 30, 1983

VERNON E. JORDAN, JR., PARTNER
AKIN, GUMP, STRAUSS, HAUER AND FELD

Mr. Jordan is a partner in a Washington law firm and trustee of the Rockefeller Foundation, the John Hay Whitney Foundation, the Taconic Foundation, and a former trustee of the New World Foundation.

Mr. Jordan's testimony was primarily devoted to the good works that various foundations have done. He stated that foundations need and deserve the support of the Congress.

In response to questions, he indicated that he thought foundations had a long way to go in having minority representation on their boards of directors. He indicated that there were several impediments to foundations created by the 1969 Act, including the five-state requirement for voter registration. He also thought that some of the self-dealing provisions of the 1969 Act have inhibited creative grant-making and cut back on foundation resources. For example, he indicated that because of the self-dealing rules the Rockefeller Foundation moved out of Rockefeller Center, and said that the cost of the move would have been better used for other charitable purposes.

In response to other questions, he indicated that a major problem facing grantees was lack of money to pursue its purposes and lack of public information about how to get grants from foundations.

M. BERNARD AIDINOFF, CHAIRMAN
SECTION OF TAXATION
AMERICAN BAR ASSOCIATION

Mr. Aidinoff indicated that many of the 26,000 members of the Section of Taxation of the American Bar Association are engaged in advising foundations and in advising grantees on how to get aid from foundations.

He believed that the 1969 legislation has accomplished Congress' purpose, ensuring that exempt foundations operate strictly in the public interest. He added that it is important to preserve the basic framework of the 1969 provisions, but suggested that certain areas were so complex and rigid that they were imposing unnecessary administrative costs or inhibiting additional contributions to foundations.

Mr. Aidinoff stated that the Tax Section endorsed the general objectives of the taxable expenditure rules, but would like to see simplification of the rules on scholarships, easing of the expenditure responsibility rules, and permitting reliance on IRS determinations of public charity status.

Proposed changes in the self-dealing rules included limiting the definition of family member to children and grandchildren, and permitting disqualified persons to provide reduced cost goods, services, and facilities to private foundations.

He indicated that generally the Tax Section believes that the present rules on excess business holdings are good rules which worked well, represented good policy, and should be retained. He suggested extending the period for divestiture of newly acquired holdings to 10 or 15 years and recommended giving the Commissioner authority to extend the divestiture period in unusual cases. He also suggested three technical changes: simplifying the pass-through rules of I.R.C. §4943(d)(1); simplifying the "downward rachet" and "substituted percentage" rules by providing that the rules do not apply to small changes in a foundation's holdings attributable to stock issuances and redemptions; and narrowing the definition of "family members" so that foundations would not have to monitor the stock holdings of remote descendants of substantial contributors.

He urged improving the first-level penalties for inadvertent violations of the prohibited transaction rules by giving the Commissioner authority to abate the first-level penalty taxes where the violation is inadvertent or the result of an unanticipated change of status and is corrected within the statutory correction period. He also suggested removing the accumulation feature of the taxes during the period of IRS administrative review.

Mr. Aidinoff advocated reducing the complexity of section 170 by applying the same limitations to both private foundations and public charities. He stated that the complexity of section 170 inhibits contributions to charity.

He proposed revising the public support rules in order to classify as public charities organizations which are directly accountable to the public and for which he believes detailed restrictions of the private foundation rules are unnecessary. He suggested broadening the unusual grant exception in determining the base of public support; giving new organizations more time to qualify as public charities—ten or twelve years instead of five; relaxing or eliminating the investment income limits which inhibit endowed organizations such as libraries and museums; and expanding the definition of public charity to include small local operating foundations.

JOHN S. NOLAN, COUNSEL
THE ROBERT A. WELCH FOUNDATION

The Robert A Welch Foundation was created for the purpose of promoting basic chemical research. It is controlled by five individual trustees who are unrelated to the creator. The foundation is an operating foundation.

In order to maintain its operating foundation status, the foundation is required to distribute "substantially all" of the lesser of its adjusted net income or its minimum investment return "directly for the active conduct of the activities constituting the purpose or function for which it is organized and operated." Treasury has interpreted "substantially all" to mean "85 percent."

Mr. Nolan stated that the problem is that in order to maintain its operating foundation status the foundation must maintain significant involvement in the programs that it funds. He contends that the level of involvement required by the IRS is not the most effective way of accomplishing the goals of the foundation. He believed that in some cases, such as endowing professorship chairs or providing equipment for basic training in chemistry, it is not practical for the foundation to maintain significant involvement.

He asked that the definition of operating foundation be amended to treat as direct expenditures grants to schools and colleges for exempt purposes in an amount equal to a fixed percentage of total qualifying distributions (e.g. 25 percent) or define "substantially all" to mean 75 percent. Another possibility he suggested was to broaden the definition of exempt-purpose qualifying distribution to include reasonable outright grants to individuals.

PANEL OF

WILLIAM T. ALDERSON, DIRECTOR
THE STRONG MUSEUM, ROCHESTER, NEW YORK

NANCY MELTON, ASSOCIATE DIRECTOR
THE MARINERS' MUSEUM, NEWPORT NEWS, VA.

THOMAS W. LEAVITT, DIRECTOR
THE MERRIMACK VALLEY TEXTILE MUSEUM
NORTH ANDOVER, MASSACHUSETTS

Mr. Alderson spoke on behalf of all three institutions. All three institutions are museums with substantial collections and professional staffs. Each is open to the public, charges a nominal fee and has thousands of annual visitors. Each receives substantial endowment income. Each museum has had or will have difficulty in meeting the requirement that its ratio of public support to its investment income be at least 10 percent in order to retain public charity status.

He stated that the museums do not have any difficulty with the restrictions on private foundations except for the requirement that donors exercise expenditure responsibility and the two percent excise tax on investment income.

He believed that the two percent excise tax is especially onerous in view of the cutbacks in funding for museum programs and when, as an alternative, the museums may need to hire professional fund raisers to meet the 10 percent public support requirement.

He endorsed H.R. 2183 (98th Cong.) which would allow museums to be excluded from private foundation rules if certain public involvement and accountability standards, not including public contributions, are met. Those standards include a permanent and tax exempt institution with 25 percent of the governing board composed of community leaders, a professional staff, and regular and continuous public exhibits. Alternatively, he supported adding to those requirements a provision that the museum must hold a certain percent of its assets in the museum's collections and that the museum must spend a certain percentage of its annual income on the museum's expenses.

He suggested a second alternative of classifying museums which meet the requirements of H.R. 2183 as private operating foundations subject to certain rules, but exempt from the two percent excise tax and exempting their donors from the expenditure responsibility requirements.

MICHAEL N. NEWMARK, COUNSEL
JAMES M. CANAVAN, JR., PRESIDENT
ST. LOUIS MERCANTILE LIBRARY ASSOCIATION

Mr. Newmark is counsel to and Mr. Canavan is president of the St. Louis Mercantile Library Association which operates a permanent library open to the public. The library is classified as a private operating foundation because it has substantial endowment income and has difficulty meeting the 10 percent public support test. This classification means that the library must pay the two percent excise tax on investment income; it must obtain legal and accounting help to assure that it falls within the private operating foundation guidelines; and it has fund-raising difficulties because of the expenditure responsibility requirements imposed on potential foundation donors.

They supported legislation which would permit a library like theirs to be classified as a public charity.

They supported H.R. 2183, which would treat certain museums and libraries as public charities. If H.R. 2183 is not sufficiently narrow, they propose adding a control requirement which would prohibit control by disqualified persons other than foundation managers or certain supporting organizations.

LARRY X. BESANT, LIBRARIAN
LINDA HALL LIBRARY, KANSAS CITY

Linda Hall Library is a science library in Kansas City, Missouri. It is open to and serves the public at no charge, but it is classified a private foundation because all but a very small portion of its income is derived from two testamentary trusts established in the 1940's.

In a written statement prepared by counsel, the library asked that the Code be amended so that libraries which are open to the general public, do not charge a fee, and are operated by organizations which spend their funds solely for the construction, maintenance, operation, or management of such a library be classified as public charities.

In oral testimony, Mr. Besant endorsed H.R. 2183, so that libraries can be treated in the same manner as other educational, research, and charitable organizations.

VIRGIL F. MASSMAN, EXECUTIVE DIRECTOR
JAMES JEROME HILL REFERENCE LIBRARY
ST. PAUL, MINNESOTA

The Hill Library is a business library which is open to the general public and provides service to small businesses in the community. According to Mr. Massman about 70 percent of the collection are unique in the area; consequently, the library performs a service not provided by other public and academic libraries in the community.

He believed that libraries which serve essentially the same function as public and academic libraries should be identified as public charities.

MRS. TOM FOLEY
OFFICE OF THE MAJORITY WHIP

Mrs. Foley introduced Bob Revel, administrator of the Hutton Settlement Children's Home in spokane, Washington. She endorsed H.R. 3343, a bill introduced at Mr. Revel's request, which would provide that orphanages would be automatically treated as public charities.

ROBERT K. REVEL, ADMINISTRATOR
THE HUTTON SETTLEMENT CHILDREN'S HOME
SPOKANE, WASHINGTON

The Hutton Settlement Children's Home is a public charity operated for the care of orphans, neglected and dependent children. The children live in a campus type setting, but they are integrated into the community. They are educated in the public schools, attend church in the community, participate in activities such as scouting and clubs in the community. Community volunteers are involved with the Home.

Mr. Revel is concerned about the 10-percent public support test which the regulations require for public charity status. The Hutton Settlement is supported by an endowment which is invested, as directdd by its founder, in commercial real estate in Spokane, Washington.

He explained that in calculating its investment income, the Settlement is required to include gross rents without deduction for operating expenses for items such as energy costs, real estate taxes and other rental expenses. This inflates investment income, and it makes it more difficult to meet the 10-percent public support test.

In addition, he stated that the Settlement finds itself in competition with other charities for public monies which it does not need except to meet the public support test. He emphasized community involvement in the orphanage and the lack of opportunity for self-dealing or other abuses. He endorsed H.R. 3343, which provides that established orphanages would be treated as public charities.

MONROE D. DOWLING, PRESIDENT
HOWARD MEMORIAL FUND

CHARLES J. TANNEBAUM, PRESIDENT
JEWISH FOUNDATION FOR THE EDUCATION OF WOMEN

The Howard Memorial Fund and the Jewish Foundation for the Education of Women are two organizations which originally supported schools and through various circumstances now fulfill their charitable purposes by awarding scholarships. Both are private foundations because of their difficulty in generating 10 percent of public support.

According to the testimony, these foundations find it difficult to generate more than 5 percent of public support because of their large endowments. The endowment is an obstacle to public fundraising, as is their private foundation status, which limits the tax benefits potential donors could receive from donating appreciated securities. Other foundations are reluctant to support them because of the expenditure responsibility requirements. In addition, they must pay 2 percent of their investment income as an excise tax.

They urged Congress to direct the Internal Revenue Service to amend its public support regulations to change the 10 percent of public support test in order that organizations established prior to 1913, whose endowment is derived from funds generated from past public support, be allowed to qualify as public charities.

QUIN R. FRAZER, COUNSEL
URANTIA FOUNDATION

URANTIA is a nonprivate exempt organization headquartered in Chicago. URANTIA's primary purpose is to distribute The URANTIA Book.

Mr. Frazer stated that URANTIA finds it difficult to maintain its public charity status because of the definition of person in IRC §509(a)(2). URANTIA sells a number of books to middlemen who then market the books to the public through bookstores. Under the Code, sales to the middlemen are viewed as sales to a "person." If the income from a particular middlemen exceeds 2% of annual income or $5,000 per year, the middlemen may be viewed as substantial contributors and thus disqualified persons. Income from substantial contributors is not counted in figuring public support. URANTIA wants the public support test in IRC §590(a)(2) to define person to include the ultimate customers of the middlemen, and not to treat the sales of books to a chain bookstore as a sale to one person.

He also suggested that the substantial contributors to IRC §509(a)(1) organizations are treated more favorably than substantial contributors to IRC §509(a)(2) organizations. He suggested amending the Code to make a yearly determination of substantial contributor status rather than applying the rule "once a substantial contributor, always a substantial contributor."

He proposed amending the declaratory judgment procedure to allow access to the courts when an administrative decision could lead to a revocation of a particular status instead of requiring an organization to wait until the status has been revoked. Under this proposal an organization could challenge IRS positions without testing the ruling by loss of public charity status.

BERNADETTE M. BROCCOLO, ESQUIRE
WILLIAM H. ROACH,JR., ESQUIRE
GARDNER, CARTON & DOUGLAS

These two lawyers represent hospitals in 29 states, and they testified about the effect of the private foundation rules on hospital corporate reorganizations. They stated that in the typical hospital corporate reorganization a single 501(c)(3) hospital creates a family of exempt corporations to perform the same functions previously carried on by the hospital. The structure might be a 501(c)(3) hospital, a fund-raising organization, a real estate holding company, a human services corporation, and a taxable business corporation, all controlled by a tax-exempt parent organization.

According to the statement, these exempt affiliates of the hospital sometimes have trouble qualifying as nonprivate foundations because of the public support requirements—specifically, the 2% limit on contributions from a single source and the 1% limit on gross receipts from a single source. This causes problems with transfers of funds between the related corporations. It is argued that private foundation status would have several disadvantages for the reorganized hospital group.

They proposed revising IRC §170(b)(1)(A) and §509(a) so that these affiliated groups, created in a reorganization, continue to qualify for public charity status.

SHELDON S. COHEN, ESQUIRE
COHEN & URETZ

Mr. Cohen was Chief Counsel and Commissioner of Internal Revenue during the period in which the Treasury study that formed the basis for the 1969 act was being prepared. His testimony provided background about the 1969 act.

He stated that he favored retaining most of the private foundation restrictions, particularly the excess business holdings restrictions. He believed that operating a business in any way by means of any kind distracts from the charitable purpose by making the foundation managers too aware and too involved in the business judgments of the controlled business. He stated that the abuses identified in 1965 still exist and are still possible.

He seemed to indicate that modifying the excess business holdings and self-dealing rules would increase the administrative burdens of the IRS.

NORMAN A. SUGARMAN, ESQUIRE
BAKER & HOSTETLER

Mr. Sugarman is a former Assistant Commissioner of the Internal Revenue Service in the Eisenhower and Truman administrations.

He believed that excess business holdings is not a proper area for the IRS to supervise. He suggested repealing IRC §4943. In the alternative, he believed that §4943 should be revised to limit the definition of family member to lineal descendants involved in running the foundation or family business and to eliminate divestiture for "present holdings" which were grandfathered in the 1969 act or which became "excess" holdings because of an increased interest acquired by a disqualified person.

He proposed granting the Secretary discretion to extend the divestiture period for "present holdings." He would allow the foundation to increase its holdings when the number of outstanding shares is increased, when stock is acquired to fund an employee benefit plan or when the disqualified persons decrease their holdings.

Mr. Sugarman would permit foundations to hold up to 50% of the voting stock, less the percentage of voting stock held by disqualified persons. He would amend the "de minimis" holdings rule from 2% to 10%.

He would amend the divestiture provision to allow 15 years for divestiture of newly acquired holdings, and would authorize the Secretary to suspend the divestiture rule where an orderly dispostion of the excess was not feasible.

JOHN E. CORBALLY, PRESIDENT
JOHN D. AND CATHERINE MACARTHUR FOUNDATION

The MacAuthur Foundation received 100% of the shares of Banker Life and Casualty Company and became an active foundation on December 1, 1978. Since that time the foundation has tried to comply with the divestitute requirement. The nature of the asset, the size of the potential transactions, and the state of the economy have worked to the disadvantage of the foundation in meeting the requirement.

Mr. Corbally endorsed H.R. 2032 which would extend the five-year divestiture period in the discretion of the Secretary. He did not support an exemption from the divestiture requirement.

RUSSELL G. MAWBY, PRESIDENT
W.K. KELLOGG ROUNDATION

The Kellogg Foundation is a general purpose grant-making foundation headquartered in Battle Creek, Michigan. The trust owns 47 percent of the common stock of the Kellogg Company. the only relationship of the trust to the company is that of shareholder, but two of the foundation's trustees also serve on the board of Directors of the Kellogg Company.

He presented figures to show that investment in Kellogg stock has outperformed government bonds, a diversified portfolio, or an all stock fund in the years since 1935. The part of their portfolio which was diversified has not done nearly as well.

Consequently, he urged the repeal of IRC § 4943 or an exemption for Kellogg stock from those provisions.

He also stated that he supported H.R. 3043.

HONORABLE JAMES R. JONES
MEMBER OF CONGRESS (OKLAHOMA)

Representative Jones called for a revision of the excess business holdings provisions, saying that this provision had a chilling effect on potential contributions to foundations and subjected foundations to a forced sale of assets at fire sale prices, without regard to any actual abuse of the foundation mechanism. He cited two foundations from his district, one created prior to the income or estate laws for care of widows and orphans and another grantmaking foundation created by a couple without lineal descendants who died in the early 1960's and never participated in managing the foundation, as examples of innocent foundations facing the fire sale problem.

JOHN S. BURKE, JR.
PRESIDENT AND TRUSTEE
ALTMAN FOUNDATION

Mr. Burke is President of the Altman Foundation and Chairman of the Board of the Altman Company, a New York based department store group. The foundation was formed in 1913 with no income or estate tax advantage to its founder. It makes grants to social welfare institutions, hospitals, libraries, universities, neighborhood associations and youth groups. Upon his death Mr. Altman left all his stock in the corporation to the foundation, a bequest made before enactment of the federal gift and estate tax law and with no tax motivation or advantage. Mr. Burke also emphasized the low operating expenses, about $70,000 compared to $790,500 distributed in 1982, and the fact that there was no self dealing, five of six trustees had no connection with the company, and only one trustee, the Treasurer, received a fee amounting to $4,500.

The primary thrust of Mr. Burke's testimony was to urge the Congress to exempt from the divestiture requirement of the excess business holding provisions, foundations, like the Altman Foundation, whose founders had not benefitted from income or estate tax deductions and where neither the donor nor any member of his family is a foundation manager. Alternatively, he asked for a five year extension for such foundations. This proposal would benefit foundations with assets acquired before the 1969 legislation. Mr. Burke maintained that unless a change was made the Altman Foundation would be forced to sell at less than a fair price. He also suggested the possibility of changing the private foundation termination provisons to permit such a foundation to pay a one time toll of 25 percent of its assets to change its status to a taxable corporation. This, he suggested, would enable the Altman Foundation and the Altman Company to continue their existence in the manner contemplated by the founder.

Attached to his statements were fairly detailed accounts of disbursements, income, and operating expenses of the Altman Foundation, and biographies of its trustees.

WALTER P. ZIVLEY
COUNSEL FOR HOUSTON ENDOWMENT, INC.

Mr. Zivley is a partner in a Houston law firm representing the Houston Endowment, organized in 1937, and having made grants for educational, medical, cultural, and charitable purposes of over $214 million dollars. It is the owner of a daily newspaper, the Houston Chronicle.

Mr. Zively urged adoption of H.R. 2589, which would permit a foundation to retain ownership of local, independent newspapers. It would remain subject to the other provisions, including the excise taxes. He argued that a compelled sale of a newspaper raised constitutional questions under the First and Fifth Amendment; that diversity of ownership should be national policy to promote press diversity; and that a sale would most certainly be to a chain, since they were most likely to make the best offer. In this regard the decrease in independent local dailies and the increase in chain ownership was cited. Further, he maintained continued ownership would not reduce tax income since the corporation and foundation would continue to pay the same taxes as at present and the corporation was liable for the some taxes as any other newspaper publisher. Finally, Mr. Zivley cited figures on advertising and circulation to show that the Chronicle's competition in Houston was not at a competitive disadvantage.

DEANE AVERY
CO-PUBLISHER AND EDITOR OF THE NEW LONDON DAY

The newspaper is owner by the Day Trust, created by Theodore Bodenwein in 1939 to allow the newspaper to survive as an independent, locally owned paper, operating in a manner specified by the trust and intended to serve the community and its employees with high standards of quality. The founder's will also provided for a second trust, the Bodenwein Public Benevolent Foundation for the benefit of his immediate family (of which there have been none since 1978) and local public and charitable purposes. Between $130,000 and $200,000 has been distributed to the foundation annually over the past ten years.

The IRS has determined that the Day Trust and the Bodenwein Foundation are subject to the private foundation rules. Prior to the death of the last family beneficiary the trust had not been treated as a private foundation under IRC § 4947, which exempts a split interest trust from such treatment. The application of the excess business holdings and minimum distribution rules to the trust would force a sale of the paper, probably to a national chain, which is what the founder sought to avoid when he set up the arrangement thirty years before the 1969 Act. It is urged that Congress adopt H.R. 1649 to provide an exemption.

The desirability of locally owned, independent newspapers and free press and due process considerations are raised in support of such an exemption. Additionally, it is urged that the abuses these provisions were intended to prevent do not exist in this case. Preventing continued family control and tax avoidance are not an issue where there are no lineal descendants. Conflicts of business and charitable concerns are, it is said, avoided by the two trust arrangement.

C. DAVIS HAINES, PRESIDENT
PUBLIC WELFARE FOUNDATION

Under current rules the Public Welfare Foundation must divest itself of 50 percent of the stock in three subsidiary corporations [The Spartanburg (S.C.) Journal and Herald, The Gadsden (Ala.) Times, and Tuscaloosa (Ala.) News] given by Charles E. Marsh to the Public Welfare Foundation through bargain sales in the early 1950's. Income from these subsidiaries has enabled the foundation to distribute over $28 million to charity. Since 1966, the newspaper corporations have paid over $24 million in taxes.

Prospective purchasers, according to Mr. Haines, have been bargain hunters or large chains, aware of the sale deadline under the tax law. The deadline threatens the value of the stock and a forced sale to a chain would (1) add to the growing concentration of ownership, (2) reduce the diversity and commitment to local concerns provided by the present form of local newspaper management, (3) jeopardize the tenure of long-term, faithful employees, (4) probably diminish newspaper donations to local charities, as well as diminishing the ability of the Foundation to increase grants as it has been able to in the past. He called for adoption of H.R. 2589 to permit foundations to continue ownership of independent, local newspapers.

HONORABLE RAY KOGOVSEK
MEMBER OF CONGRESS (COLORADO)

Mr. Kogovsek introduced Mr. Bill Hybl, chairman of the El Pomar Foundation.

He stated that the whole Colorado delegation was concerned with the El Pomar Foundation and the Broadmoor Hotel, which is historically important to Colorado. He endorsed H.R. 3458, which he introduced to provide an exemption from the excess business holdings divestiture requirements for the El Pomar Foundation.

WILLIAM J. HYBL, PRESIDENT
EL POMAR FOUNDATION

The El Pomar Foundation was established in 1937 and had made over $72 million in grants in its history. The foundation is sole owner of the Broadmoor Hotel, Inc., a resort hotel built by the founder. The property includes an arena, ski area, three golf courses and some 2000 surrounding acres. No member of the founder's family has been associated with the El Pomar Foundation or the hotel since 1956. Mr. Hybl urges the adoption of an exception from the excess business holdings divestiture requirement for this holding.

He noted that the resort hotel accounts for something less than 20 percent of the foundation's assets and eleven other companies have been divested. The hotel has and should be retained, according to Mr. Hybl because it is an appreciating asset providing a good rate of return to the foundation and the managers hired by the foundation recognize its importance in the history of the local area and promote local interests. The witness maintained the potential purchasers are limited to hotel chains or conglomerates, likely to be less responsive to local interests, and that potential purchasers in this small sale market are aware of the divestiture requirement and waiting for a bargain sale. Furthermore, the foundation publicizes its activities for prospective grantees, makes current distributions of income for charitable purposes, and has engaged in no acts of self-dealing; and the hotel is subject to corporate income taxes in the same manner as other hotel corporations. There is no unfair competition or perpetuation of donor control, two of the prime reasons for the excess business holdings requirement. For these reasons, he urged adoption of an exemption.

A. Z WELLS FOUNDATION
MELVIN R. BROWN, PRESIDENT
WELLS & WADE FRUIT COMPANY

Mr. Brown appeared on behalf of the A. Z. Wells Foundation, located in the State of Washington, which has excess business holdings subject to divestiture under the present law in the Wells and Wade Hardware Company and the Wells and Wade Fruit Co. Because of the fact that the companies are small and shares are unlisted, a sale would probably require disposition of the companies or their assets in their entirety with uncertain consequences for employees and the local economy. For this reason Mr. Brown urged exemption for holdings acquired prior to 1969, where activities are esentially unchanged and operation is not controlled by or benefitting any disqualified person. It was noted that, because of limits in the creating instrument, grants were limited to specified agencies and that inflation in land values (more than doubled from 1980 to 1982) made satisfying the 5 percent payout requirement impossible, (it was 2.94 percent in 1982). Relief from this provision was also requested by limiting payout to net income received. Letters from four beneficiaries supporting relief were submitted.

VESTER T. HUGHES, COUNSEL
H.E. BUTT FOUNDATION

The Butt Foundation was established by Mr. and Mrs. Howard E. Butt in the 1930's and has a permanent endowment of about $2 million at present. Mr. and Mrs. Butt have included in their will since before 1969 a bequest of a substantial amount of the preferred stock in a supermarket chain which would be subject to divestiture. The dividend is presently 6 percent of par value with an estimated present fair market value of 40 percent of par. A yield of 15% on the proceeds would be required to provide equivalent income. These proceeds would approximate the annual gifts being made by Mr. and Mrs. Butt, but a forced sale would reduce income ana diminish their charitable capacity.

Mr. Hughes presented several options for modifying the excess business holdings provision ranging from repeal to extension of the divestiture period, excluding nonvoting preferred stock from the provision, allowing sales to disqualified persons with adequate sageguards to insure fairness, and allowing retained holdings where the foundation shows the absence of abuse. The absence of abuse, he suggested, might be shown if control is insignificant (e.g., nonvoting stock), shares are not readily saleable except at bargain prices, management is separate, and shares generate at least the minimum investment return for four of every five years.

ROBERT J. REARDON, TRUSTEE
OTTO BREMER FOUNDATION

The Bremer Foundation is sole shareholder in the Otto Bremer Company, a multistate, registered, bank holding company, with majority control of 29 banks and 39 bank related companies in Minnesota, Wisconsin, and South Dakota. Because of the nature of the corporation and the fact that it is subject to various limits and agency regulations as a bank holding company, as well as a private foundation, divestiture has been difficult, according to the witness. Antitrust limitations and lack of interest from foreign buyers have made sale of the holding company impossible, and Mr. Reardon says that sale of individual banks is more difficult and likely to be less profitable than disposition of the holding company. This he feels could be done by a public offering of stock except for certain ambiguities in the law (IRC § 4943) as it applies to a bank holding company. Specifically, he says it is not clear whether divestiture periods are to be determined by looking to the holding company or looking through it to individual banks and whether the holding company is a business enterprise. Regulations announced but not issued in 1979 would have clarified the situation. He asks that Congress enact legislation (H.R. 4943, S. 977) to clarify their status under § 4943, making a bank holding company a business enterprise and making it clear that you do not look through a qualified bank holding company to determine the ownership interest of a private foundation. Such changes would, said Mr. Reardon, permit the foundation to offer the stock to the public with the assurance that the company could operate in the same manner as any other such company and enable the company to comply with divestiture in the time permitted by the present law. He emphasized no exemption or extension was being sought, and discussed efforts to sell, legal limits barring bank holding companies (Citicorp or Bank of America) from other areas from a purchase, antitrust problems for locally operating holding companies, and efforts to interest foreign investors, noting that both the Senate and House, at different times, had approved legislative relief for the Bremer Foundation, the only bank holding company/foundation and hence, the only one with this peculiar set of problems.

EUGENE T. ROSSIDES, COUNSEL
MORRIS AND GWENDOLYN CAFRITZ, FOUNDATION

Mr. Rossides is a partner in the law firm of Rogers and Wells and appeared on behalf of the Morris and Gwnedolyn Cafritz Foundation, a large foundation serving the Washington Metropolitan Area and a major supporter of local cultural, educational, medical, and charitable organizations such as the National Symphony, Corcoran Art Gallery, Red Cross, Columbia Hospital and Gallaudet College. The foundation was principal beneficiary of Mr. Cafritz's will. He died in 1964 leaving 2/3 interest in his assets to the Cafritz Foundation and 1/3 in a marital trust, which is a "disqualified person" under the 1969 Act. Most of the active businesses have been disposed of with only passive real estate investments and 2/3 interest in a real estate management company.

Under the law, as written, interests of the foundation and disqualified persons are aggregated for application of the 15 year period to those with 75% interest, but not aggregated for the 95% used for the 20 year transition period. There is according to the witness, no apparent reason for the difference. Indeed he argued that problems of sale of a large interest is more difficult where, as here, a marital trust and foundation own over 95% of the stock than where it is owned by the foundation alone. As of now the foundation would be forced to sell 3/4 of its stock (in a currently depressed real estate market) by May 26, 1984. Given five more years, Mr. Rossides said, the problems for this particular foundation might be resolved. There is, he maintained no apparent reason for not applying the same aggregating rule to the 20 year period as to the 15 year period, and no tax money is lost nor any abuse promoted by using the rule for aggregation.

JAMES E. WEGER, PRESIDENT
HAUSS - HELMS FOUNDATION

This foundation was established in 1965 for the purpose of assisting students in a two-county area of Ohio with post-high school education. It received approximately 52 percent of the shares in the Telephone Service Co. of Wapakoneta, Ohio from the estates of its founders, and presently the foundation and 11 disqualified parties own 50 percent of the stock. Mr. Weger requested a legislative exemption from the excess business holdings provision for the foundation's ownership of this local telephone company.

It was, he maintained, profitable—with a return of 17.08 percent of book value and 7.29 percent of fair market value in 1982. The value of the stock had increased 134.25 percent since 1965. He noted that many of the concerns of abuse by Congress were not applicable. It is a publicly regulated monopoly in its franchise and can't unfairly compete, maintains low cost and efficient service (one rate increase in 30 years), and no trustees are family members or remotely related to them. Mr. Weger noted that the House had adopted a proposal providing an extension of the divestiture period for the Hauss-Helms Foundation in the 95th Congress, but no action was taken by the Senate.

BARRY A. GERSICK, COUNSEL
MURPHY MOTOR FRIEGHT LINES

Mr. Gersick is a partner in a St. Paul, Minnesota law firm. The Murphy Freight Lines has had a long relationship with the Wasie Foundation, created by a former 1/2 owner of the trucking company. Mr. Murphy gave $9,000 over a 4 year period shortly after its creation and when total contributions were about $51,000. Now the total foundation assets are over $11 million, with over $ 10 million in gifts.

After Mr. Wasie's death relations between the Mr. Murphy and Wasie interest deteriorated, counter tender offers were made and Mr. Murphy acquired control, with the Wasie trust still owning 27.6% of the stock. They subsequently brought several suits against Murphy and others relative to the tender offer. After negotiation an agreement was reached to sell their interest to Mr. Murphy for $9.00 per share (1/4 in cash and 3/4 with an 8 1/4 percent debenture). The price was $3.75 per share above the last reported bid price, the rate of return on the debenture equal to prime, and the offer made to all stockholders.

An IRS audit in the Spring of 1983 determined Murphy was a substantial contributor (he gave $9,000 to a Foundation now with $11 million) and a disqualified person. The IRS proposed first and second tier taxes of over $2.7 million, proposed corrective action including payment of over $730,000 and prepayment of the debenture issued as a purchase instrument. The IRS views the debenture as a separate act of self dealing, though accepting the position that the transaction itself was a redemption and, as such, did not constitute self-dealing.

Mr. Gersick argued that such a result was not intended and that an exemption should be included where the act is one in settlement of litigation; that some change should be made in defining a substantial contributor to avoid including within the definition small, early contributors, whose contributions are infintesimal as compared to other but later gifts; and that credit extended in redemption should be treated as part of the permissible redemption and not as a separate act of self dealing.

DR. CHARLES S. BROWN, VICE PRESIDENT
CLARA ABBOTT FOUNDATION

Dr. Brown testified on behalf of the Clara Abbott Foundation, formed in 1940 pursuant to a bequest of stock in Abbott Laboratories by the widow of the founder of the corporation. Under the terms of the will the bequest was to be used for the benefit of active and former employees of Abbott Laboratories and their dependents. No contributions have been received from the corporation.

Since 1945 a large portion of its income has been used for college loans and scholarships to children of active and former employees who demonstrate financial need and academic promise. As a result of Revenue Procedures setting guidelines to determine whether grants are taxable expenditures made under an employer related program, the loan program has been discontinued for beginning students and will end in its entirety in 1984, unless the rules are changed.

While Dr. Brown found most of the guidelines in Revenue Procedure 76-47 acceptable and intended to insure an objective, nondiscriminatory program, he objected to the percentage tests which limit the number of scholarships to 25 percent of the applicants or 10 percent of the eligibles and to the extension of this limit to loans and the requirement they be aggregated with scholarships in applying the percentage test under Revenue Procedure 80-39. He asked for IRS reconsideration of aggregating loans and scholarships or legislative action to achieve that end.

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The witnesses addressed the difficulties in meeting the pass-through requirements where the gifts take the form of real property. They suggested elimination of pass-through or extending the time to three years, as opposed to present law requiring disposition within the tax year, or two and one-half months thereafter. Under present law a reduction in the contribution deduction to recapture capital gains is required in the absence of a pass through within the prescribed time frame. The Mobil Foundation is funded annually by contributions of surplus property from Mobil Corporation.

The witnesses argued that the change was desirable because of difficulties encountered in such cases in disposing of such property, noting the time involved in marketing, negotiating, financing, surveying, etc. While indicating support for H.R. 3043, which would eliminate the pass-through requirement entirely and treat gifts of appreciated property to foundations in the same way as gifts of such properties to public charities, the witnesses also offered a narrower proposal to give private foundations three years to pass through contributions of appreciated real property, and to modify the deduction provision to provide for a recapture from the donor where the pass-through does not occur. Elimination of pass-through, they noted, is the simplest approach, and the alternative adds to complexity in the code. Nevertheless, it is suggested as a possible alternative if the pass-through requirement is retained. Both would, it was said, encourage gifts of such properties, some which are presently rejected because of the anticipated complexity of their disposition.

APPENDIX E.—STATISTICAL INFORMATION

Appendix E contains statistical information developed by the General Accounting Office, the Internal Revenue Service, and the Foundation Center. Tables 1 and 2 present information concerning foundation resources and expenses. Tables 3-7 present information regarding the number of private foundations and their assets. Tables 8 and 9 discuss foundation grant activities and Tables 10-13 show the largest foundations by various measures. Table 14 presents information on foundations by State.

TABLE 1.—OVERVIEW OF PRIVATE FOUNDATION RESOURCES AND EXPENSES AS MEASURED IN ACTUAL AND CONSTANT DOLLARS 1962–1981

Selected years [1]	Number of foundations	Foundation financial data in millions of actual dollars				Foundation financial data in millions of constant (1972) dollars [2]			
		Assets at market value	Total receipts	Total expenses	Disbursements for exempt purposes	Assets at market value	Total receipts	Total expenses	Disbursements for exempt purposes
1962	14,865	16,262	1,898	(3)	1,012	23,031	2,688	(3)	[4] 1,433
1974	26,889	(3)	2,792	2,717	2,409	(3)	2,430	2,361	[4] 2,093
1977	27,691	34,817	4,369	3,001	2,692	24,900	3,125	2,142	[4] 1,922
1978	29,659	36,735	4,933	3,516	3,101	24,482	3,288	2,337	[4] 2,061
1979	27,980	44,648	6,013	3,536	3,246	27,321	3,679	2,164	[4] 1,986
1980	32,618	48,023	7,323	3,993	(5)	26,882	4,099	2,235	(5 6)
1981	31,866	50,980	9,059	4,808	(5)	26,075	4,633	2,459	(5 6)

[1] Selected years were dictated by data availability.

[2] Implicit Price Deflator for Gross National Product as developed by the Department of Commerce, Bureau of Economic Analysis, was applied to actual dollars to compute constant 1972 dollars.

[3] Not available.

[4] Source is GAO analysis of data from SOI Bulletin (Pub. 1136) dated October 1982, and Private Foundations 1974–78 (Pub. 1073) dated April 1981, Statistics of Income Division, Internal Revenue Service, Department of the Treasury.

[5] Data not available. However, data on contributions paid, which based on prior year data generally accounts for about 85 percent of exempt purpose disbursements, totaled about $3.1 billion in 1980 and $3.7 billion in 1981 as measured in actual dollars. These contributions, in constant 1972 dollars amounted to about $1.8 billion in 1980 and $1.9 billion in 1981.

[6] Source is GAO analysis of IRS Master File data as reported to IRS Exemption Organizations Division.

TABLE 2.—OVERVIEW OF 1979 PRIVATE FOUNDATION REVENUE AND EXPENSES BY SIZE AS MEASURED BY BOOK VALUE OF ASSETS

	Foundation asset size at book value						
	0 or not reported	1 under 25,000	25,000 under 100,000	100,000 under 1,000,000	1,000,000 under 10,000,000	10,000,000 and over	Total
Total number of foundations	1,223	8,557	5,967	8,717	3,026	490	27,980
Revenue:							
Donations received	$4,499,589	$79,175,936	$81,180,726	$339,931,956	$667,075,340	$1,115,655,784	$2,287,519,331
Percent of total revenue	85	84	73	55	42	31	38
Number of foundations	238	4,397	2,701	3,786	1,374	212	12,708
Percent of total foundations	19	51	45	43	45	43	45
Passive income	$1,945,635	$7,698,883	$23,651,044	$226,529,704	$676,086,575	$1,681,701,251	$2,617,613,093
Percent of total revenue	37	8	21	36	43	47	44
Number of foundations	281	5,395	5,636	8,540	3,002	483	23,339
Percent of total foundations	23	63	94	98	99	99	83
Business income	0	$2,572,875	$1,735,786	$7,730,919	$26,598,952	$11,825,563	$50,464,095
Percent of total revenue	0	3	2	1	2	0	1
Number of foundations	0	230	90	166	105	35	626
Percent of total foundations	0	3	2	2	3	7	2
Other income	−$1,127,277	$4,549,527	$4,851,987	$47,428,441	$202,533,409	$799,292,352	$1,057,528,440
Percent of total revenue	−21	5	4	8	13	22	18
Number of foundations	55	1,435	1,841	4,549	2,338	424	10,641
Percent of total foundations	4	17	31	52	77	87	38
Total revenue	$5,317,948	$93,997,221	$111,419,543	$621,621,021	$1,572,294,275	$3,608,474,950	$6,013,124,957
Number of foundations	450	7,421	5,919	8,684	3,023	488	25,985
Percent of total foundations	37	87	99	100	100	100	93
Expenses:							
Compensation	$346,521	$17,273,432	$7,792,545	$27,910,181	$80,175,549	$135,075,704	$268,573,932
Percent of total expenses	3	16	9	6	8	7	8
Number of foundations	88	890	1,098	2,670	1,581	369	6,697
Percent of total foundations	7	10	18	31	52	75	24
Professional services	$359,547	$2,351,192	$2,407,016	$11,781,705	$24,303,641	$40,227,138	$81,430,239
Percent of total expenses	3	2	3	3	2	2	2
Number of foundations	223	2,320	2,773	5,181	2,295	434	13,226
Percent of total foundations	18	27	46	59	76	89	47

Contributions	$9,638,324	$76,611,972	$66,140,423	$355,048,655	$775,515,591	$1,518,044,591	$2,800,999,557
Percent of total expenses	78	70	76	80	77	81	79
Number of foundations	372	5,927	5,226	7,896	2,683	460	22,564
Percent of total foundations	30	69	88	91	89	94	81
Other expenses	$1,945,553	$13,629,904	$11,157,875	$49,069,436	$126,571,619	$182,392,282	$384,766,668
Percent of total expenses	16	12	13	11	13	10	11
Number of foundations	372	6,654	5,647	8,509	2,993	481	24,655
Percent of total foundations	30	78	95	98	99	98	88
Total expenses	$12,289,945	$109,866,499	$87,497,859	$443,809,977	$1,006,566,400	$1,875,739,715	$3,535,770,396
Number of foundations	510	7,821	5,909	8,667	3,016	487	26,410
Percent of total foundations	42	91	99	99	100	99	94
Excess revenue over expense	−$6,972,023	−$15,869,795	$23,921,166	$177,810,102	$565,727,451	$1,732,735,169	$2,477,352,070
Total number of foundations	1,223	8,557	5,967	8,717	3,026	490	27,980
Summation:							
Foundations with excess revenues	55	3,538	3,437	5,760	2,145	384	15,319
Percent of total foundations	4	41	58	66	71	78	55
Foundations with deficits	319	4,359	2,456	2,905	871	104	11,014
Percent of total foundations	26	51	41	33	29	21	39
Foundations breaking even	849	660	75	52	10	2	1,647
Percent of total foundations	69	8	1	1	0	0	6
Total number of foundations	1,223	8,557	5,967	8,717	3,026	490	27,980

Source: GAO analysis of IRS statistics of income division random sample database of 1979 private foundation returns. Data represents estimates projected to the universe of foundations.

TABLE 3.—PRIVATE FOUNDATIONS AND ACTIVE SECTION 501(c)(3) ORGANIZATIONS

As of December 31	Private foundations	Section 501(c)(3) organizations [1]
1982	33,308	300,800
1981	31,866	297,800
1980	32,618	305,900
1979	31,824	292,500
1978	31,319	281,200
1977	30,149	269,200
1976	28,821	252,200
1975	28,407	231,300
1974	28,243	219,700
1973	25,703	224,800
1972	23,172	207,800
1971	(2)	(2)
1970	(2)	(2)
1969	(2)	(2)

[1] Including private foundations—rounded to nearest hundred. These figures do not represent a true universe of section 501(c)(3) organizations because certain organizations such as churches, their integrated auxiliaries, and conventions or associations of churches need not apply for recognition of exemption unless they desire to receive a ruling. When issued, the ruling letter goes to the central organization but it covers all of its subordinate units. Only the central organization is established on the exempt organization masterfile where it is counted as one entity in the figure as stated above. However, this one ruling may represent a large number (tens of thousands) of subordinate units, as in the case of larger religious groups. An exception is subordinate units considered nonintegrated auxiliaries, which are established and included in the above figures since they may be required to file information returns as prescribed under section 6033.

[2] Not available.

Source: EO Masterfile Tables, Internal Revenue Service.

TABLE 4.—FORM 990-PF FINANCIAL DATA

[In billions of dollars]

Return year [1]	Col. (a) [2] fair market value of assets	Col. (b) [2] revenue	Col. (c) [2] expenses and disbursements	Col. (d) [2] contributions, etc. paid [3]
1981	$51.0	$9.0	$4.8	$3.7
1980	48.0	7.3	4.0	3.1
1979	37.6	5.5	3.1	2.4
1978	34.6	4.4	2.9	2.0
1977	36.4	4.5	2.8	2.0
1976	35.3	4.1	2.8	2.0

[1] A return year consists of all returns filed and posted (over a 2-year period) for a given year and whose annual accounting period ends in that year.

[2] These columns correspond to the following line items on the 1982 Form 990-PF, or equivalent items on prior years' returns: Col. (a)—in header; Col. (b)—line 13, Col. A; Col. (c)—line 24, Col. A; Col. (d)—line 23, Col A.

[3] Included in Expenses and Disbursements.

Source: EO Masterfile Tables, Internal Revenue Service.

Note: See IRS SOI studies of 1974 and 1979 returns for a more detailed and comprehensive analysis of private foundations' financial return information. (Pub. 1136 (10-82) SOI Bulletin, Fall 1982; and Pub 1073 (4-81) SOI 1974-1978, Private Foundations).

TABLE 5.—BREAKDOWN OF FOUNDATIONS BY ASSET CATEGORIES [1]

Asset category	Number of foundations	Assets	Grants
$100 million plus	58	$17,042,553,000	$815,055,550
$50 million to $99,999,999	56	3,960,848,900	236,379,760
$10 million to $49,999,999	442	9,002,594,300	572,584,130
$5 million to $9,999,999	476	3,331,876,600	278,107,140
$1 million to $4,999,999	2,336	5,129,477,100	441,633,570
$500,000 to $999,999	1,823	1,296,116,400	136,714,690
$250,000 to $499,999	2,491	879,310,140	110,207,020
$100,000 to $249,999	3,774	611,120,000	94,130,408
$50,000 to $99,999	2,780	200,655,220	43,997,044
$25,000 to $49,999	2,420	88,123,088	37,039,728
$10,000 to $24,999	2,321	39,301,232	28,829,850

TABLE 5.—BREAKDOWN OF FOUNDATIONS BY ASSET CATEGORIES [1]—Continued

Asset category	Number of foundations	Assets	Grants
Under $10,000	3,558	12,100,008	53,127,964
Total	22,535	41,594,073,879	2,847,797,509

[1] Details may not add to totals because of rounding.

Source: Foundation Center, National Data Book, 6th Edition. 1982.

TABLE 6.—BREAKDOWN OF FOUNDATIONS BY GRANT CATEGORIES [1]

Grant Category	Number of Foundations	Grants	Assets
$25 million plus	10	$460,380,960	$8,162,702,800
$10 million to 24,999,999	18	235,403,010	3,450,346,200
$5 million to $9,999,999	46	313,720,930	4,797,723,600
$1 million to $4,999,999	363	717,093,500	9,225,311,200
$500,000 to $999,999	424	295,094,140	3,423,317,200
$100,000 to $499,999	2,304	406,583,330	6,421,070,300
$50,000 to 99,999	1,864	132,093,400	2,265,265,900
$25,000 to $49,999	2,582	91,355,064	1,245,777,200
$5,000 to $24,999	7,456	91,336,960	1,570,166,300
Under $5,000	7,468	14,744,231	1,032,404,000
Total	22,535	2,847,797,509	41,594,073,879

[1] Detail may not add to totals because of rounding.

Source: Foundation Center, National Data Book, 6th Edition, 1982

TABLE 7.—TYPES OF ORGANIZATIONS RECEIVING GRANTS

	Total value of grants	Percent [1]	Number of grants	Percent [1]
Educational institutions	$514,512,965	41.0	6,981	31.2
Private universities and colleges	278,392,767	22.2	3,403	15.2
Public universities and colleges	88,312,669	7.0	1,459	6.5
Graduate schools	92,033,023	7.3	890	4.0
Junior/community colleges	3,405,773	0.3	73	0.3
Schools	52,368,733	4.2	1,156	5.2
Direct service agencies	207,672,799	16.5	5,981	26.8
Hospitals and medical care facilities	114,774,092	9.1	1,489	6.7
Research institutes	91,039,640	7.2	992	4.2
Associations and professional societies	70,088,978	5.6	1,883	8.4
Museums and historical societies	60,706,283	4.8	904	4.0
Performing arts groups	45,409,159	3.6	1,424	6.4
Government agencies	36,850,553	2.9	518	2.3
Community funds	36,140,525	2.9	608	2.7
Libraries	33,308,912	2.7	358	1.6
Churches and temples	10,513,774	0.8	284	1.3

[1] Percentages based on 22,322 grants with a total value of $1,257,056,099.

Source: Foundation Center, Foundation Grants index. 11th edition, 1982.

TABLE 8.—DISTRIBUTION OF GRANTS BY SUBJECT CATEGORIES IN 1980 AND 1981

	Dollar value of grants				Number of grants			
	1980		1981		1980		1981	
	Amount	Percent	Amount	Percent	Number	Percent	Number	Percent
Cultural activities:								
General	$23,762,428	2.0	$52,323,219	4.2	534	2.5	776	3.5
Art and architecture	36,277,014	3.0	43,139,967	3.4	498	2.3	554	2.5
History	16,876,510	1.4	12,772,923	1.0	328	1.5	360	1.6
Language and literature	9,753,803	0.8	20,066,708	1.6	227	1.0	302	1.4
Media and communications	26,987,020	2.3	20,915,886	1.7	492	2.3	399	1.8
Music	23,439,983	2.0	24,513,970	1.9	610	2.8	799	3.6
Theater and dance	23,697,126	2.0	18,827,272	1.5	602	2.8	688	3.0
Total cultural activities	160,793,884	13.5	192,559,945	15.3	3,291	15.2	3,878	17.4
Education:								
General	18,951,152	1.6	22,764,612	1.8	444	2.0	506	2.3
Adult and continuing	9,163,695	0.8	9,867,033	0.8	128	0.6	122	0.5
Elementary and secondary	36,321,496	3.0	46,130,529	3.7	1,053	4.9	997	4.5
Higher (general)	198,304,497	16.7	181,576,053	14.4	2,949	13.7	2,717	12.2
Vocational	3,670,572	0.3	5,513,078	0.4	145	0.7	164	0.7
Total education	266,431,412	22.4	265,851,305	21.1	4,719	21.9	4,506	20.2
Health:								
General	4,542,588	0.4	15,445,092	1.2	116	0.5	224	1.0
Medical and health education	63,758,605	5.4	67,511,595	5.4	553	2.6	587	2.6
Medical care and treatment	146,611,811	12.3	118,571,590	9.5	1,593	7.4	1,750	7.8
Medical research	59,209,996	5.0	53,290,926	4.2	610	2.8	569	2.5
Mental health	11,246,674	0.9	14,254,591	1.1	357	1.7	446	2.0
Public health	13,549,063	1.1	13,457,808	1.1	265	1.2	170	0.8
Total health	298,918,710	25.1	282,531,602	22.5	3,494	16.2	3,746	16.7
Religion:								
General			9,330,573	0.8			232	1.0
Religious education			15,348,099	1.2			172	0.8
Total religion	28,718,935	2.4	24,678,672	2.0	718	3.3	404	1.8
Science:								
General			22,689,341	1.8			229	1.0
Life sciences			31,027,168	2.5			325	1.5
Physical sciences			17,776,009	1.4			399	1.8
Technology			15,235,026	1.2			315	1.4
Total science	75,466,392	6.4	86,727,544	6.9	1,375	6.3	1,268	5.7
Social science:								
General			22,981,978	1.8			316	1.4
Anthropology			944,350	0.1			19	0.1
Economics			12,695,560	1.0			260	1.2
Law and legal education			12,343,675	1.0			218	1.0
Political Science			26,465,713	2.1			460	2.1
Total social science	67,977,493	5.7	75,431,276	6.0	1,182	5.5	1,273	5.8
Welfare:								
General	61,309,538	5.1	73,616,556	5.9	2,076	9.7	2,488	11.1
Business and employment	25,874,641	2.2	37,485,732	3.0	810	3.8	692	3.1
Community affairs	67,820,185	5.7	80,868,899	6.4	1,507	7.0	1,685	7.5
Consumer interests			479,061	0.03			22	0.1
Crime and law enforcement			10,371,000	0.8			207	0.9
Environment and conservation	36,616,832	3.0	46,271,003	3.7	587	2.7	589	2.6
Equal rights and legal services	29,303,435	2.5	16,088,325	1.3	584	2.7	361	1.6
Recreation	35,808,927	3.0	38,886,934	3.1	718	3.3	774	3.5

TABLE 8.—DISTRIBUTION OF GRANTS BY SUBJECT CATEGORIES IN 1980 AND 1981—Continued

	Dollar value of grants				Number of grants			
	1980		1981		1980		1981	
	Amount	Percent	Amount	Percent	Number	Percent	Number	Percent
Rural development	5,459,422	0.5	7,050,882	0.6	84	0.4	89	0.4
Urban development	30,299,992	2.5	18,157,363	1.4	445	2.0	340	1.5
Total welfare	292,222,972	24.5	329,275,755	26.2	6,811	31.6	7,247	32.4
Total grants	1,190,799,798	100.0	1,257,056,099	100.0	21,590	100.0	22,322	100.0

Source: Foundation Center.

TABLE 9.—GRANTS AWARDED TO SPECIAL GROUPS

	Dollar value of grants				Number of grants			
	1980		1981		1980		1981	
	Amount	Percent	Amount	Percent	Number	Percent	Number	Percent
Aged	$24,428,374	2.0	$18,010,803	1.4	466	2.2	484	2.2
Alcohol/drug addicts	4,364,642	0.4	3,159,280	0.3	161	0.7	154	0.7
Children and youth	86,507,700	7.3	123,552,714	9.8	2,677	12.4	3,133	14.0
Criminal and ex-offenders	7,168,404	0.6	8,435,017	0.7	218	1.0	211	0.9
Handicapped	19,411,746	1.6	22,062,891	1.8	737	3.4	808	3.6
Men and boys			12,154,657	1.0			257	1.2
Minorities	22,078,451	1.9	23,360,983	1.9	557	2.6	453	2.0
Asian-Americans			1,470,530	0.1			66	0.3
Blacks	22,960,139	1.9	35,696,678	2.8	398	1.8	583	2.6
Hispanics	7,574,670	0.6	10,182,753	0.8	189	0.9	257	1.2
Native Americans	4,842,633	0.4	4,913,173	0.4	109	0.5	123	0.6
Women and girls	20,533,990	1.7	36,670,100	2.9	634	2.9	966	4.3

Source: Foundation Center.

TABLE 10.—LARGEST FOUNDATIONS BY ASSETS

[In dollars]

Name	Assets	Total grants
Ford Foundation	2,782,942,000	103,370,000
Robert Wood Johnson Foundation	1,027,530,645	39,777,683
Andrew W. Mellon Foundation	880,365,610	57,883,814
John D. and Catherine T. MacArthur Foundation	862,372,401	2,263,928
Pew Memorial Trust	829,976,732	41,466,953
Lilly Endowment, Inc	812,877,257	20,703,626
Rockefeller Foundation	805,571,941	44,111,750
W.K. Kellogg Foundation	769,109,811	47,670,993
Kresge Foundation	655,408,031	29,767,887
Charles Stewart Mott Foundation	407,115,114	28,937,800
Duke Endowment	363,590,076	27,284,260
San Francisco Foundation	348,166,242	9,736,772
Carnegie Corporation of New York	346,116,271	10,822,755
Richard King Mellon Foundation	283,517,063	12,909,385
Houston Endowment Inc	254,282,589	13,658,464
Alfred P. Sloan Foundation	252,057,634	12,415,248
New York Community Trust	245,649,317	16,291,610
J.E. and L.E. Mabee Foundation, Inc	239,506,880	8,832,157
Bush Foundation	217,830,310	8,302,828
Edna McConnell Clark Foundation	210,911,000	11,488,000
Moody Foundation	206,687,509	9,158,105
James Irvine Foundation	205,830,393	11,486,999
Cleveland Foundation	202,390,308	10,034,159
Gannett Foundation, Inc	201,558,324	5,565,982
Samuel Roberts Noble Foundation, Inc	196,221,626	10,685,043
Henry J. Kaiser Family Foundation	195,075,070	9,032,327
Brown Foundation, Inc	188,293,633	16,041,140
J. Howard Pew Freedom Trust	184,150,385	8,337,214
Weingart Foundation	176,227,967	6,496,058
Surdna Foundation, Inc	176,051,369	9,277,020
Norton Simon Foundation	175,368,665	113,320
McKnight Foundation	173,727,101	7,285,452
Rockefeller Brothers Fund	162,547,537	32,641,681
Ahmanson Foundation	162,326,732	6,793,519
Joyce Foundation	144,424,952	6,255,538
Starr Foundation	143,013,037	3,597,352
Commonwealth Fund	138,633,217	9,035,400
Robert A. Welch Foundation	134,320,202	7,358,652
De Rance, Inc	132,998,373	11,936,700
Meadows Foundation, Inc	130,912,696	3,549,288
Sherman Fairchild Foundation, Inc	130,113,712	4,019,859
Norton Simon, Inc. Museum of Art	124,484,992	417,924
Amherst H. Wilder Foundation	122,095,964	65,000
John A. Hartford Foundation, Inc	120,085,062	5,297,969
Herbert H. and Grace A. Dow Foundation	119,956,662	3,745,587
Alcoa Foundation	118,721,776	6,381,300
Mabel Pew Myrin Trust	118,135,943	6,487,700
M.J. Murdock Charitable Trust	117,605,842	6,518,772
Clark Foundation	113,761,958	3,361,571
Northwest Area Foundation	112,570,881	6,664,656

Source: Foundation Center, The Foundation Directory, 8 Edition. 1981.

TABLE 11.—50 LARGEST FOUNDATIONS BY TOTAL GRANTS

[In dollars]

Name	Total grants	Assets
Ford Foundation	103,370,000	2,782,942,000
Andrew W. Mellon Foundation	57,883,814	880,365,610
W. K. Kellogg Foundation	47,670,993	769,109,811
Rockefeller Foundation	44,111,750	805,571,941
Pew Memorial Trust	41,466,953	829,976,732
Robert Wood Johnson Foundation	39,777,683	1,027,530,645
Rockefeller Brothers Fund	32,641,681	162,547,537
Kresge Foundation	29,767,887	655,408,031
Charles Stewart Mott Foundation	28,937,800	407,115,114
Duke Endowment	27,284,260	363,590,076
Lilly Endowment, Inc.	20,703,626	812,877,257
New York Community Trust	16,291,610	245,649,317
Brown Foundation, Inc	16,041,140	188,293,633
Houston Endowment, Inc	13,658,464	254,282,589
Ford Motor Company Fund	13,182,729	50,914,446
Atlanic Richfield Foundation	13,083,951	18,769,521
Richard King Mellon Foundation	12,909,385	283,517,063
General Motors Foundation	12,871,496	87,768,691
Alfred P. Sloan Foundation	12,415,248	252,057,634
Dan Murphy Foundation	12,137,530	82,206,415
Exxon Education Foundation	12,066,034	13,775,004
De Rance, Inc	11,936,700	132,998,373
Edna McConnell Clark Foundation	11,488,000	210,911,000
James Irvine Foundation	11,486,999	205,830,393
Cullen Foundation	11,213,425	77,082,885
Krannert Charitable Trust	11,140,000	58,188,628
Carnegie Corporation of New York	10,822,755	346,116,271
Samuel Roberts Noble Foundation, Inc	10,685,043	196,221,626
Cleveland Foundation	10,034,159	202,390,308
San Francisco Foundation	9,736,772	348,166,242
Surdna Foundation, Inc	9,277,020	176,051,369
Moody Foundation	9,158,105	206,687,509
Irwin-Sweeney-Miller Foundation	9,144,634	5,475,063
Commonwealth Fund	9,035,400	138,633,217
Henry J. Kaiser Family Foundation	9,032,327	195,075,070
W. M. Keck Foundation	8,983,520	15,212,139
J. E. and L. E. Mabee Foundation, Inc	8,832,157	239,506,880
Harry G. Steele Foundation	8,563,140	28,482,360
Vincent Astor Foundation	8,504,555	55,310,378
John L. and Helen Kellogg Foundation	8,501,500	12,990,597
J. Howard Pew Freedom Trust	8,337,214	184,150,385
Bush Foundation	8,302,828	217,830,310
Amon G. Carter Foundation	8,218,907	102,337,701
Robert A. Welch Foundation	7,358,652	134,320,202
McKnight Foundation	7,285,452	173,727,101
Mobil Foundation, Inc	7,247,774	14,602,097
Dayton Hudson Foundation	7,059,272	7,120,276
BankAmerica Foundation	7,011,264	22,415,098
William Penn Foundation	6,894,779	101,921,501
Ahmanson Foundation	6,793,519	162,326,732

Source: Foundation Center, The Foundation Directory, 8th Edition. 1982.

TABLE 12.—15 LARGEST INDEPENDENT FOUNDATIONS

[In dollars]

Foundation name	Assets	Total grants
Ford Foundation	2,782,942,000	95,746,000
Robert Wood Johnson Foundation	1,027,530,645	39,777,683
Andrew W. Mellon Foundation	880,365,610	57,883,814
John D. and Catherine T. MacArthur Foundation	862,372,401	2,263,928
Pew Memorial Trust	829,976,732	41,466,953
Lilly Endowment, Inc	812,877,257	20,703,626
Rockefeller Foundation	805,571,941	30,214,526
W. K. Kellogg Foundation	769,109,811	47,132,774
Kresge Foundation	655,408,031	29,767,887
Charles Stewart Mott Foundation	407,115,114	28,937,800
Duke Endowment	363,590,076	27,284,260
Carnegie Corporation of New York	346,116,271	10,822,755
Richard King Mellon Foundation	283,517,063	12,909,385
Houston Endowment Inc	254,282,589	13,658,464
Alfred P. Sloan Foundation	252,057,634	10,695,004

Source: Foundation Center, The Foundation Directory, 8th Edition, 1982.

TABLE 13.—15 LARGEST COMPANY-SPONSORED FOUNDATIONS

[In dollars]

Foundation name	Assets	Total grants
Alcoa Foundation	118,721,776	5,267,940
General Motors Foundation	87,768,691	12,871,496
Ford Motor Company Fund	50,914,446	12,102,805
Prudential Foundation	49,443,000	3,776,173
Amoco Foundation, Inc	49,183,894	5,211,723
McDonnell Aerospace Foundation, Inc	42,661,244	2,608,428
Eastman Kodak Charitable Trust	36,895,566	4,918,020
Shell Companies Foundation, Inc	33,973,232	5,052,475
Western Electric Fund	28,868,514	4,133,367
United States Steel Foundation, Inc	28,461,080	6,394,075
Metropolitan Life Foundation	27,053,156	2,118,298
Aetna Life & Casualty Foundation	27,018,552	3,504,538
Texas Philanthropic Foundation, Inc	25,039,716	
General Electric Foundation	23,574,000	4,040,296
BankAmerica Foundation	22,415,098	6,759,966

Source: Foundation Center, The Foundation Directory, 8th Edition, 1982.

TABLE 14.—ANALYSIS OF FOUNDATIONS BY STATE

State	Number of foundations	Percent	Assets (market value)	Percent	Total giving	Gifts received
Alabama	156	0.7	$100,837,091	0.2	$8,749,862	$8,585,959
Alaska	9	....	2,400,414	....	272,407	435,066
Arizona	108	.5	96,999,933	.2	7,431,710	5,813,268
Arkansas	126	.6	76,791,497	.2	6,021,742	9,861,119
California	1,620	7.2	3,525,641,278	8.5	240,774,435	490,193,627
Colorado	217	1.0	374,034,441	.9	26,531,191	10,026,425
Connecticut	554	2.5	700,482,811	1.7	50,131,769	42,912,987
Delaware	130	.6	417,096,806	1.0	20,766,776	6,737,643
District of Columbia	207	.9	383,812,993	.9	22,018,378	23,896,342
Florida	630	2.8	534,157,410	1.3	33,238,925	30,760,902
Georgia	391	1.7	536,176,003	1.3	39,406,915	15,961,905
Hawaii	77	.3	139,733,486	.3	6,277,990	1,613,440
Idaho	45	.2	23,930,392	.1	1,767,300	677,619
Illinois	1,486	6.6	1,964,630,348	4.7	149,109,855	512,523,714
Indiana	424	1.9	1,238,849,596	3.0	64,761,485	18,527,274
Iowa	277	1.2	135,440,719	.3	13,227,540	11,382,675
Kansas	202	.9	106,598,682	.3	9,972,428	7,059,623
Kentucky	122	.5	146,897,157	.4	9,428,303	3,438,669
Louisiana	186	.8	157,697,535	.4	7,797,474	7,121,561
Maine	100	.4	32,593,297	.1	2,347,911	1,586,524
Maryland	393	1.7	301,448,554	.7	25,900,900	12,524,283
Massachusetts	1,270	5.6	871,629,990	2.1	65,880,893	39,744,856
Michigan	701	3.1	2,843,967,724	6.8	194,265,129	43,667,977
Minnesota	465	2.1	1,148,737,371	2.8	95,778,726	102,864,550
Mississippi	81	.4	61,147,103	.2	2,257,000	2,094,356
Missouri	525	2.3	625,175,291	1.5	50,075,444	32,737,484
Montana	52	.2	15,103,002	....	916,563	1,038,360
Nebraska	156	.7	95,337,034	.2	5,651,955	16,519,494
Nevada	25	.1	5,867,969	....	559,245	201,439
New Hampshire	176	.8	54,171,183	.1	4,037,036	1,902,599
New Jersey	678	3.0	1,625,867,019	3.9	106,889,790	49,347,841
New Mexico	34	.2	12,421,993	....	1,528,501	746,619
New York	4,567	20.3	11,875,104,308	28.6	773,691,500	294,359,882
North Carolina	408	1.8	880,225,872	2.1	62,425,171	14,838,017
North Dakota	35	.2	8,631,009	....	654,700	537,051
Ohio	1,088	4.8	1,559,405,454	3.8	131,189,550	67,688,374
Oklahoma	182	.8	771,513,395	1.9	38,747,486	10,154,516
Oregon	200	.9	156,159,036	.4	12,228,712	5,011,213
Pennsylvania	1,289	5.7	3,382,438,939	8.1	219,490,394	77,345,596
Puerto Rico	3	....	9,997,789	....	35,728	315,714
Rhode Island	124	.6	133,933,856	.3	9,396,076	8,933,742
South Carolina	139	.6	120,150,950	.3	7,166,906	6,973,255
South Dakota	37	.2	7,885,475	....	456,491	1,609,356
Tennessee	228	1.0	327,287,444	.8	20,580,744	5,088,222
Texas	1,083	4.8	2,736,108,017	6.6	189,030,516	107,000,981
Utah	93	.4	68,714,023	.2	4,610,553	30,112,652
Vermont	42	.2	32,517,106	.1	1,259,816	377,038
Virginia	356	1.6	256,568,849	.6	20,307,768	14,197,471
Washington	296	1.3	339,205,017	.8	24,499,142	25,103,147
West Virginia	60	.3	38,581,104	.1	3,190,766	3,151,745
Wisconsin	649	2.9	497,775,639	1.2	52,789,837	28,714,384
Wyoming	33	.1	36,194,475	.1	2,270,075	267,099
Total	22,535	100	41,594,073,879	100	2,847,797,509	2,214,285,655

Note: Details may not add to totals because of rounding.

Source: Foundation Center, National Data Book, 6th Edition, 1982.